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WHAT'S SEX GOT TO DO WITH IT? TAX AND THE "FAMILY"

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May 15, 2000

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Ce document est également disponible en français sous le titre *La fiscalité, la « famille » et le sexe : quel rapport?*

SUMMARY

In this paper the author analyses the taxation rules that recognise spousal and family relationships. She notes that even though we file income tax returns as individuals, the federal *Income Tax Act* recognises spousal and familial relationships for many different purposes, thereby undermining the integrity of the principle of the individual as the tax unit. She observes that Parliament has responded over the years to the ever-changing demographics of "family" life in Canada by amending references in the Act to spousal and other family relationships. For example, the meaning of "spouse" has been expanded to become more inclusive. Most recently, with Bill C-23 the Act would be amended to treat lesbian and gay couples in the same manner as heterosexual common-law couples. In spite of the many changes made, however, a fundamental policy question remains to be considered: is it appropriate for income tax laws to be concerned with spousal and other family relationships? The author tackles this question by examining whether any of the rules that are based on spousal or familial relationships could be removed from the Act and whether those that should remain ought to be reconfigured to make them more fair in their application.

Her enquiry takes into account the underlying purposes of the tax system and the basic tenets of tax policy enquiry, as well as examining the impact of the respective tax provisions on different taxpayers from an "equality" perspective. The paper tracks the legislative history of some of the key tax rules involving spousal and family relationships. It classifies and critiques each rule by reference to the tax policy rationales behind the rule. Among the rules considered are the attribution rules, which are intended to stop income splitting between spouses and between adults and minor children. The author concludes that more empirical research is needed on the potential consequences of eliminating these rules before a recommendation to retain or repeal them can be made. The author does recommend the repeal of rules based on dependency, including the spousal tax credit and the ability to transfer unused tax credits to a spouse. Provisions based on economic mutuality are also assessed, both those that result in less or more tax payable by the taxpayer. The author finds that some of these rules should be retained because they do serve valid objectives, however others such as the inclusion/deduction system for spousal support payments are indefensible.

This paper provides the first comprehensive review of the federal tax rules that take spousal and family relationships into account. Other scholarly analyses of tax rules related to spousal and family relationships have framed the issue in terms of whether spouses should be taxed as individuals or as a joint unit. However, this paper explores the more fundamental question – whether it is appropriate to recognise spousal and family relationships for any purpose in the Act – and the author finds that in many instances, but not all, rules taking these relationships into account cannot be justified and should be removed from the Act.

BIOGRAPHICAL NOTES

Claire Young is a Professor of Law at the Faculty of Law, the University of British Columbia. She teaches, researches and writes on all aspects of tax law and policy, and is currently engaged in work that focuses on women and tax. She has published extensively in the tax area and is co-author of two books and the author of numerous articles on tax law and policy. In 1999 she wrote a major report commissioned by Status of Women Canada which examined the impact on women of delivering social programs through the tax system. She is currently working on a book "Taxing Times for Women: Critical Perspectives on Canadian Tax Policy". Most recently, she held the Dunhill Madden Butler Visiting Chair in Women and the Law at the University of Sydney, Australia from February to May 1999.

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INTRODUCTION

> Taking account of taxpayers' conjugal relationships in determining their tax liability reduces the effectiveness of the tax system in achieving an appropriate distribution of society's resources, misperceives the nature of tax law, leads to serious horizontal inequities, hinders the achievement of gender equity, complicates the tax system, intrudes into the privacy of intimate relationships, and furthers male dominance in the private realm.[1]

In theory, because the individual is the unit of taxation in Canada it should make no difference whether or not a taxpayer is in a relationship and, if so, whether that relationship is recognized by the state.[2] In fact, even though we file tax returns as individuals, the *Income Tax Act*[3] recognizes spousal and familial relationships[4] for many different purposes. In some cases this is an advantage for the spouses because the total tax liability of the couple is less than if the relationship was not recognized. In other cases there is the disadvantage of an increased tax burden. There are over 190 references to child and over 400 references to spouse in the Act, and many more references in the regulations.[5] Until recently, the definition of spouse has been confined to those in heterosexual relationships. On April 11, 2000 Bill C-23, an omnibus legislation containing amendments to sixty-eight pieces of legislation, including amendments to the *Act* to treat lesbian and gay couples in the same manner as heterosexual common law couples, was passed by the House of Commons.[6] The Bill is now before the Senate. In the context of this report it is important to note that such a change, while of benefit to some lesbians and gay men,[7] merely expands the definition of spouse to make it more inclusive. The issue of the appropriateness of recognizing spousal and familial relationships for tax purposes remains one for consideration.

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[1] Neil Brooks, "The Irrelevance of Conjugal Relationships in Assessing Tax Liability" in Richard Krever and John Head eds., *Tax Units and the Tax Rate Scale* (Melbourne: Australian Tax Research Foundation, 1996) at 36.

[2] It should be noted that the Royal Commission on Taxation (the Carter Commission) recommended in 1966 that the family be the unit of taxation for all purposes. That recommendation was not incorporated in the new *Income Tax Act* that was enacted effective January 1, 1972. See Government of Canada, *Report of the Royal Commission on Taxation* (Ottawa: Government of Canada, 1966).

[3] *Income Tax Act*, R.S.C. 1985, (5th. Supp.) c. I-5, as amended, hereinafter referred to as the Act.

[4] In this report the term "spousal relationship" refers to spouses as defined in section 252(4) of the Act. That section defines a spouse of the taxpayer as a person of the opposite sex who cohabits with the taxpayer in a conjugal relationship and has so cohabited with the taxpayer for 12 months or who cohabits in a conjugal relationship with the taxpayer and is a parent of a child of whom the taxpayer is also a parent. For the 2001 and subsequent taxation years, the reference to spouse will be changed to that of common law partner and that term will include persons of the same-sex with the same requirements to be met in terms of the nature and duration of the relationship. The term "familial relationship" means, in the context of this report, the relationship between a parent and child.

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[5] See Appendix B for the list of all the provisions in the Act. It should be noted that with respect to the references to "child", the report only considers those references that are to a child of the taxpayer. Therefore references to a person under 18 years of age who is also a child for the purposes of the Act are not discussed. The reason is that the focus of this report is on family relationships and, while a person under 18 may be a child of the taxpayer, that is not always the case. It is also important to note that the term "child" has different meanings depending on the context. For example, the "extended meaning" of child in section 252(1) of the Act states that a child of a taxpayer includes a person of whom the taxpayer is the natural parent, a person under 19 who is wholly dependent on the taxpayer for support and in respect of whom the taxpayer has custody and control, a child of the taxpayer's spouse, an adopted child of the taxpayer and a spouse of a child of the taxpayer. This section applies throughout the Act, except where it is expanded or limited by a particular definition for limited purposes. Therefore, for example, section 70(10) which applies to the rollover of farm property to a child on a tax-free basis defines a child for the purposes of that rollover as also including a child of the taxpayer's child, a child of the taxpayer's child's child and a person under 19 who was dependent on the taxpayer for support and in respect of whom the taxpayer had custody and control. As can be seen from these definitions, while a person under 19 who is dependent on the taxpayer for support and in respect of whom the taxpayer has custody and control is a child, the age of the child is not relevant in other circumstances. In this report, the focus is only on those relationships that include parents and their children, that is the family relationship.

[6] Bill C-23, *The Modernisation of Benefits and Obligations Act*, as passed by the House of Commons on April 11, 2000.

[7] For an analysis of the impact of the inclusion of lesbians and gay men as spouses in the Act, see Claire Young, "Taxing Times for Lesbians and Gay Men", (1994) 17 *Dalhousie Law Journal* 534. In fact the impact of being treated as spouses varies depending on the level of income of each individual in the couple and the distribution of that income between the individuals. For example, the couple in which both partners have low incomes that are relatively equal in amount will pay more tax as a couple than they would as individuals because of the decrease in the amount of their entitlement to the Goods and Services Tax credit which is based on "family" income.

The references to spousal and familial relationships are intended to accomplish a variety of tax policy objectives. For example, some of the rules are anti-avoidance rules that are intended to stop tax savings through income splitting and the consequent erosion of the tax base.[8] Rules such as the attribution rules ensure that income from property transferred in certain circumstances to a spouse or child is included in the income of the transferor not the transferee. There are other rules that also have a negative impact on spouses or families by basing entitlement to certain "tax subsides", [9] such as the Goods and Services Tax Credit and the Canada Child Tax Benefit, on "family income". The consequence of these rules is that the spouses will receive less of the subsidy as a couple than they would if they were treated as two separate individuals. The policy underlying these provisions recognizes that while two do not necessarily live as cheaply as one, there is a certain advantage based on economies of scale. The theory is that, unlike two individuals, the spouses require only one home, one washer and dryer and so on.[10] Other rules give a tax advantage to those in spousal and family relationships. For example, the economic dependence of one spouse on another is recognized with the provision of tax subsidies such as the spousal tax credit. Other tax measures recognize the economic mutuality within spousal and family units by, for example, permitting certain properties to be transferred within the unit on a tax-free basis and thereby deferring any tax that would otherwise be payable until the property is ultimately disposed of by the spouse or child.

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[8] Income splitting involves the diversion of income from a high rate taxpayer to a taxpayer who pays tax at a lower rate. This diversion of income frequently takes place between spouses or between parents and their children or grandchildren.

[9] The issue of what constitutes a tax subsidy is discussed in detail in Chapter One.

[10] As I shall discuss later, this argument is flawed, especially in an era where more people than ever before are sharing accommodation and therefore benefiting from economies of scale, even though they are not in a spousal relationship.

While the tax system continues to recognize spousal and familial relationships for a variety of purposes, the demographics of "family" life in Canada are changing. As I discuss in Chapter One, the traditional nuclear family is on the decline. Marriage rates are dropping, and divorce and separation are on the increase. The rate of childbirth has declined and many parents are having children later in life. There are more lone parent families than ever before, with women predominantly heading these families. The role of women in society is also changing. More women than ever before are participating in the paid labour force, although many of these women are employed on a part time basis. Despite this change, women's work in the home remains undervalued and is not considered productive work. Yet some things remain the same. Women continue to be the primary caregivers of children and perform more household labour than men. In the labour force, women continue to earn less than men and they are less wealthy than men. All these social and economic factors must form the backdrop for any analysis of the rules that recognize spousal and familial relationships.

This report will consider the issue of whether any of the rules that are based on spousal or familial relationships can be removed from the Act. The approach is as follows: Chapter One presents a brief overview of the tax system and discusses the purposes of the tax system in order to provide a policy background to the issue. This Chapter also considers the criteria by which we evaluate the fairness of our tax system and this analysis is the foundation on which the later discussion of the impact of the rules is based. Finally, Chapter One examines the changing demographics of the family in order to locate the subsequent discussion of the need for the rules in the current social and economic context. It also reviews the potential impact of the *Modernization of Benefits and Obligations Act*[11] on the income tax system.

Chapter Two sets the historical framework by tracing the evolution of the definition of spouse in the *Income Tax Act*. The intention is to follow the development of some of the most important rules and thereby aid in the understanding of why these rules were originally enacted and how they have changed over the years. Such an understanding will allow for an informed discussion about the relevance of the rules in the year 2000. Chapter Two also identifies and categorizes every rule in the Act that applies to "spouses", "married persons" and "children". (See Appendix A for the complete list of these rules with a brief description of their application.) This taxonomy is the first step in the consideration of which rules should be retained and which might be eliminated and in determining how some of the rules might be reconfigured to make them fairer in their application. It is also the most complete and comprehensive listing and description to date of these rules.[12]

Chapter Three is an in depth analysis and critique of all the rules identified and categorized in Chapter Two. The Chapter draws on the framework provided in Chapter

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[11] *Supra* note 6.

[12] Several other authors have provided a list and description of some of the tax rules that apply to spouses, but none have listed and described every single such provision, preferring to focus on the more important rules. See, for example, David Sherman, "Till Tax Do Us Part: The New Definition of 'Spouse'", *1992 Conference Report* (Toronto: Canadian Tax Foundation, 1992) 20:1; Maureen Maloney, "What is the Appropriate Tax Unit for the 1990s and Beyond?" in Allan Maslove ed., *Issues in the Taxation of Individuals* (Toronto: University of Toronto Press and the Ontario Fair Tax Commission, 1994) 116; Kathleen Lahey, *The Political Economies of Sex and Canadian Income Tax Policy*, presentation to the Canadian Bar Association (Ontario), Lesbian and Gay Legal Issues Committee, 1998 (unpublished) and Albert Wakkary, "Assessing the Impact of Changing Marital Rights and Obligations: Practical Considerations" (2000) 17 *Canadian Journal of Family Law*, 200.

One and considers the pros and cons of the various rules, taking into account the purposes of the tax system, the criteria by which we evaluate our tax system and the current demographics with respect to family relationships. The Chapter examines the policy underlying the various provisions, considers whether that policy remains valid today and makes recommendations about how to remove some of the problems inherent in the rules that apply to spousal and familial relationships. In some cases, such as the attribution rules, the report calls for the collection of more empirical data before a recommendation can be made with respect to any amendment to, or repeal of, the rules. In other cases, the report calls for the repeal of the rule. For example, a detailed analysis of the rules that recognize dependency in spousal relationships concludes with the recommendation that the spousal tax credit and the rules that permit an individual to transfer unused tax credits to a spouse should be repealed. Sometimes the report recommends reform of a rule to make it operate in a fairer manner, such as the recommendation that the child-care expense deduction be converted to a refundable tax credit. In each case the recommendation is preceded by a detailed analysis of the rule, the policy underlying it and a description of its operation.

This report is the first comprehensive review of the tax rules that take spousal and familial relationships into account. While there has been work done on the impact on taxpayers of some of the individual rules that relate to spousal and familial relationships, that analysis has tended to take place in the context of consideration of the appropriate tax unit.[13] The issue has been framed as one that looks to whether spouses should be treated as one unit for tax purposes and required to file a joint return. The context of this report is not the issue of the appropriate tax unit, but rather the issue of whether it is appropriate to recognize spousal and family relationships for any purpose in the *Act*. The aim of this report is to allow the reader to understand how the income tax system compromises the integrity of the individual as the unit of taxation, to demonstrate why this is problematic and to provide suggestions that will permit an informed discussion of the policy options available.

---

[13] There has been some excellent critical work on the issue of what is the appropriate tax unit and that literature has discussed many of the rules that are analysed in this report. See, for example, Neil Brooks, *supra* note 1, Maureen Maloney, *Women and Income Tax Reform : A*

Background Paper (Ottawa: Canadian Advisory Council on the Status of Women, 1987); Kathleen Lahey, *The Taxation of Women in Canada, A Research Report* (Faculty of Law, Queens University, 1988, unpublished report); Maureen Maloney, "What is the Appropriate Tax Unit for the 1990s and Beyond?" *ibid.*; Ontario Fair Tax Commission, Women and Taxation Working Group, *Women and Taxation* (Toronto: Ontario Fair Tax Commission, 1992) and Claire Young, "Taxing Times for Women: Feminism Confronts Tax Policy" in Richard Krever ed. *Tax Conversations* (United Kingdom: Kluwer Law International, 1997).

CHAPTER ONE

TAX POLICY ANALYSIS

I. OVERVIEW OF THE TAX SYSTEM

Income taxes are levied both by the federal government and by the provincial and territorial governments. Income tax is payable on an individual's world-wide income. The *Income Tax Act* taxes on the basis of the source of that income with the result that different rules may apply in the computation of that income, depending on the source of the income. The main sources of income are employment income, business income, property income, other income and capital gains. The Act requires that a taxpayer compute their net income by including certain amounts from each source in income and taking any allowable deductions. Taxable income is net income less any other deductions such as losses carried over from previous years. Federal tax payable is a percentage of taxable income. At present there are three federal rates of tax (17% on the first $29,590 of income, 26% on the amount of income in excess of $29,590 up to $59,180 and 29% on the amount in excess of $59,180).[14] Once federal tax payable has been calculated the taxpayer may apply any non-refundable federal tax credits available. These will reduce the amount of tax payable. Examples of these tax credits include the personal tax credit, the marital (spousal) tax credit, the dependant tax credit, the charitable donations tax credit, and the political donations tax credit. The next step is to calculate the federal surtax which is 5 per cent of basic tax payable.[15] Finally, tax is reduced by any refundable tax credits available and if taxable income is reduced to zero the credit can result in a refund to the taxpayer, even though no tax was payable. Examples of refundable tax credits include the GST tax credit and the Canada Child Tax Benefit.

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[14] These rates will be changed for the 2000 and subsequent taxation years. Subsection (4) of the *Notice of Ways and Means Notice to Amend the Income Tax Act*, dated February 28, 2000 and released as part of the February 2000 budget provides as follows:

> That the calculation of an individual's tax otherwise payable under Part 1 of the Act be modified to reduce the 26 per cent tax rate applicable to the portion of the individual's taxable income in excess of $29,590 and less than $59,180 (those two threshold amounts being indexed) to
>
> a) 25 per cent for the 2000 taxation year, and
> b) 24 per cent for the 2001 and subsequent taxation years,
>
> such that the rate structure for the 2000 year be
>
> a) 17 per cent to taxable income up to $30,004
> b) 25 per cent of taxable income between $30,004 and $60,009, and
> c) 29 per cent of taxable income that exceeds $60,009.

The federal government and all provinces except Quebec have entered into agreements whereby the federal government collects income taxes for the provinces.[16] Quebec imposes and collects its own income taxes, applying a system that is similar to the federal system in structure, although it is fully independent of the federal system. The provinces that have entered into tax collection agreements with the federal government levy an income tax that is a percentage of federal tax payable. The amount of the provincial income tax varies from province to province and for the 1999 taxation year the rates range between a high of 69% in Newfoundland (plus a surtax of 10% on provincial tax payable in excess of $10,000) to a low of 39.50% in Ontario. The agreements also permit the provinces to provide certain tax credits to taxpayers that are provincial in nature.

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[15] The federal surtax is to be reduced to 4 per cent for the 2001 and subsequent taxation years, and it will eventually be eliminated in by 2005. *Ibid.* at subsection (5).

[16] *Federal-Provincial Fiscal Arrangements Act*, R.S.C. 1985, c. F-8. s.7.

In Quebec there are three rates of tax, 20 per cent on the first $25,000 of income, 23 per cent on income in excess of $25,000 up to $50,000 and 26 per cent on the amount in excess of $50,000. While the structure of the Quebec tax system is similar to the federal system, there are differences in the specific provisions. In the context of this report the main difference that will be focused on relates to the child-care expense deduction.

II. PURPOSES OF A TAX SYSTEM

> [T]axation depends on choices made collectively about what goods and services should be provided through government, what proportion of the income of society should be redistributed among its members, how the revenue needed to provide those goods and services should be raised, and how the tax system should be used to influence the decisions of individuals.[17]

An income tax system is a multi-faceted government program. Arguably, it is the government's most important policy instrument because its impact is so far reaching, affecting all Canadians on a daily basis in so many different ways. Obviously one of its primary objectives is to raise revenue to be spent on government programs, but that is only part of its role. Our tax system is increasingly being used to achieve other goals, although which goals take precedence over others varies from time to time as the political climate changes.[18] Some of the other functions of a tax system include redistributing economic resources when the private market fails in this regard, redistributing income to reduce the inequalities between rich and poor, imposing additional costs in order to fulfil a regulatory function and stabilizing the economy. Different tools are used to achieve different goals. Therefore, for example, progressive marginal tax rates are intended to ensure that there is a more equal distribution of disposable income than there would be if all taxpayers paid tax at the same rate regardless of their income. It is important when considering the impact of any changes to the tax rules to recognise that a particular rule may fulfil more than one function and this study will identify the purposes of all the rules that relate to spouses and children.

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[17] Ontario Fair Tax Commission, *Fair Tax in a Changing World, A Report* (Toronto: University of Toronto Press in co-operation with the Ontario Fair Tax Commission, 1993) at 32.

[18] For an excellent analysis of the changing objectives of the tax system, see Neil Brooks, "The Changing Structure of the Tax System: Accommodating the Rich", (1993) 13 *Osgoode Hall Law Journal* 137.

The tax system also fulfils a spending function. In 1973 Stanley Surrey wrote the classic text in which he developed the tax expenditure concept.[19] His thesis was that any measures, such as income exclusions, deductions, deferrals or tax credits, which depart from a normative tax system are tax expenditures. That is, rather than funding a particular activity or program by way of a direct grant, the subsidy is delivered through the tax system. Tax expenditures are used for a variety of purposes, including to redistribute income, to encourage certain economic behaviour and to fund social and economic programs. [20] The concept has captured the imagination of many, including the federal government which incorporates tax expenditure analysis in the budget process and publishes annual accounts which list the cost of every tax expenditure.[21] The insights provided by this theoretical framework are many, including a recognition that because the tax measures are part of a spending program, their effectiveness should be measured by criteria other than the traditional tax policy evaluative methods discussed below such as equity, neutrality, economic efficiency and simplicity. Budgetary criteria, such as whether the measure is target efficient, should play a greater role in our evaluation of tax expenditures. I would submit that equality is also a key issue for consideration in the evaluation of a particular measure. Given that the allocation of a significant amount of money is at stake it is important to identify who benefits from the expenditure and, of course, who does not.

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[19] Stanley Surrey, *Pathways to Tax Reform* (Cambridge: Harvard University Press, 1973).

[20] In a fascinating review of Stanley Surrey and Paul McDaniel's 1984 text *Tax Expenditures*, Neil Brooks makes the point that while Surrey and McDaniel did coin the phrase "tax expenditures", the concept of the tax system as a spending tool was not a novel concept. Brooks traces the evolution of the concept back to 1863 and an attack by William Gladstone on the income tax exemption for charities. The arguments made by Gladstone bear an uncanny resemblance to many of the arguments currently made for not funding social and economic programs through the tax system. For example, Gladstone said of the tax exemption, "here we maintain from year to year and from generation to generation what we are pleased to term an exemption, that is to say a public grant, but a public grant which we never investigate, and never weigh. We plume ourselves in liberality; we leave this great expenditure in the dark." Gladstone continued, "If we have a right to give public money we have no right to give it in the dark. We are bound to give it with discrimination: bound to give it with supervision" as quoted in Neil Brooks, "Review of Surrey and McDaniel Tax Expenditures" (1986) 34:3 *Canadian Tax Journal* at 684.

III. FAIRNESS OF A TAX SYSTEM

> The achievement of a fair tax system in a democracy is rightly regarded as a matter of high economic and social importance.[22]

Traditional tax policy analysis has judged the effect of tax measures and, to a certain degree, their fairness by reference to three particular factors, namely, horizontal and vertical equity, neutrality and simplicity. Underpinning these criteria are the normative values of income taxation based on ability to pay, which recognises that some are more easily able to contribute than others, and taxation as a tool for income redistribution. The hallmark of taxation based on ability to pay is the progressivity of the tax system. A progressive system is one that imposes graduated rates of tax with the result that those with higher incomes pay tax at a higher rate on that higher amount of income.

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[21] See, for example, the most recent tax expenditure account, *Tax Expenditures 1999* <http://www.fin.gc.ca/taxexp/taxexp99_le.html>.

[22] John Head, "Tax Fairness Principles" in Allan Maslove ed., *Fairness in Taxation: Exploring the Principles* (Toronto: University of Toronto Press in co-operation with the Fair Tax Commission of Ontario, 1993) at 4.

Horizontal equity is defined as the requirement that equals be treated equally. That is, all persons in the same circumstances should be treated in the same manner. Therefore, for example, one can argue that two people with the same amount of income should pay the same tax. But horizontal equity is an increasingly difficult concept to pin down. The key issue when deciding whether this criterion is being adhered to is determining which individuals are "similarly situated". For example, as Neil Brooks has pointed out, the long-standing tax policy view that two individuals with the same amount of income should pay the same amount of tax is being challenged in the name of lower taxes for the rich.[23] The argument is that such a point of comparison means that the return on individuals' savings is included in income and that is unfair to the person who is thriftier in their habits. Thus the call is being made for the point of comparison not to be the amount of income each individual earns but rather the value of their consumption. This kind of analysis leads to regressive taxation and undermines the basic tenet of taxation based on ability to pay.

Vertical equity requires that persons in differing situations be treated in an appropriately different manner. Again this criterion is closely connected to the principle of taxation based on ability to pay. One can argue that adherence to the principle of vertical equity has been eroded over time, especially since the 1987 "tax reform" process. At that time the number of tax rates was reduced from ten to three and the top federal rate was reduced from 34 per cent to 29 per cent. Even though we have seen an increase in top tax rates because of surtaxes, the system is not as progressive as it was prior to the 1987 reform.[24] In addition, the introduction of the Goods and Services Tax, a flat rate consumption tax has meant a further decrease in the progressivity of the tax system.[25] Furthermore, there are frequent calls from many quarters, including several provincial governments, for a general lowering of tax rates. Such a move could well further detract from the progressivity of the system, thus further eroding the vertical equity of the tax system.

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[23] Neil Brooks, *supra* note 18 at 181-184.

The criterion of neutrality requires that the tax system does not distort taxpayers' social and economic choices. For example, the decision whether or not to work in the paid labour force or the decision to spend money rather than save should not be influenced by the workings of the tax system. Underlying this concept of neutrality is the concern that distortion of economic choices may result in a misallocation of resources because taxpayers may choose to direct money into activities that receive preferential tax treatment, rather than those that do not. But it is not only economic choices that should not be distorted by the tax system. In the context of this study, social choices such as the choice to marry or to live in a common law relationship or to remain single should not be made as a consequence of any preferential tax treatment that would ensue from choosing one life style over another.

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[24] Indeed, the income tax rate structure has steadily become less progressive. The earlier major tax reform in 1972 saw a reduction in the number of tax rates from fourteen to ten with a lowering of the top federal rate to 47 per cent.

[25] An income tax credit with respect to the GST was implemented when the tax was introduced in an attempt to reduce some of the regressive effects of the flat rate tax (section 122.5 of the *Act*.) Nevertheless, the credit does not mitigate entirely the regressive effect of the tax, see,

While the phrase "a simple tax system" may appear to be somewhat of an oxymoron, it is clear that most people would support the idea that a tax system should be as simple as possible. It is important that taxpayers understand the impact of the tax rules on them and their activities. It is also important that the taxing authorities are able to administer the system, something that becomes more difficult as the system becomes more complex. Thus, simplicity is another criteria by which we judge the effectiveness of the tax system.

While the principles discussed above are an important foundation of our tax system, recently some authors have commented on how traditional tax policy analysis has, in the past, omitted a very important element, that is equality among particular groups in society.[26] Maureen Maloney, for example, has pointed out that "[w]hile current interpretations of equity, both vertical and horizontal, may catch class biases, they do not go far enough because the need for equity is generally recognised with respect only to the distribution of income."[27] Evaluation of the tax system by reference to equality is not as limited in scope as some of the approaches discussed above. It requires an examination of the impact of the rules on particular groups in society to determine if they are treated in a prejudicial manner. In this study the focus is consideration of whether the

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Neil Brooks, *Searching for an Alternative to the GST* (Discussion Paper 90 C.1) (Ottawa: The Institute for Research on Public Policy, 1990).

[26] In Canada, the Canadian Advisory Council on the Status of Women first noted this omission. See Maureen Maloney, *Women and Income Tax Reform: A Background Paper* (Ottawa: Canadian Advisory Committee on the Status of Women, 1987) at 2.

[27] Maureen Maloney, "What is the Appropriate Tax Unit for the 1990s and Beyond?" in Allan Maslove ed., *Issues in the Taxation of Individuals* (Toronto: University of Toronto Press, 1994) 116 at 118.

current rules that distinguish between taxpayers who are in spousal relationships and those who are not result in unequal treatment for any particular group.

Any analysis of the equal application of income tax rules must take into account that equality does not merely mean formal equality. Rather, the analysis must also encompass the concept of substantive equality. An approach based on formal equality would treat all individuals the same regardless of the differences between them. It has been said that this approach "is inadequate to the task of creating real equality because it does not encompass or even acknowledge inequality of condition. Substantive equality recognizes that in order to achieve equality, different groups in society may require different treatment."[28] It has been put this way by the Supreme Court of Canada:

> In fact, the interests of true equality may well require differentiation in treatment. In simple terms, then, it may be said that a law which treats all identically and which provides equality of treatment between "A" and "B" might well cause inequality for "C", depending on the differences in personal characteristics and situations. To approach the ideal of full equality before and under the law - and in human affairs an approach is all that can be expected - *the main consideration must be the impact of the law on the individual or group concerned.* [emphasis added][29]

An example of formal equality in the tax context is the gender neutrality of tax legislation. Each provision applies to both men and women and yet, as I have discussed in other work[30], women suffer significant substantive inequalities when compared to men in terms of the impact of the system on them.

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[28] Gwen Brodsky and Shelagh Day, *Canadian Charter Equality Rights for Women: One Step Forward or Two Steps Back?* (Ottawa: Canadian Advisory Council on the Status of Women, 1989) at 150.

[29] *Andrews* v. *The Law Society of British Columbia*, [1989] 1 S.C.R. 143 at 165 *per* McIntyre J.

[30] See, for example, Claire Young, "(In)visible Inequalities: Women, Tax and Poverty" (1995) 27 *Ottawa Law Review*, 99 and Claire Young, "Taxing Times for Women: Feminism Confronts Tax Policy" in R. Krever ed., *Tax Conversations* (United Kingdom: Kluwer Law International, 1997).

IV. CHANGING DEMOGRAPHICS OF THE FAMILY

> In Canada, as in a number of industrialized countries, domestic and family behaviours have become much more diversified in the past thirty years. One aspect of this diversification is that new forms of unions have appeared, and the unions formed have become less stable. Another is that sequences of transitions in the family life course have proliferated.[31]

It is clear that the demographics of the family have changed considerably since the introduction of the income tax system. In the 1940s and 1950s the dominant picture was that of the nuclear family comprised of a married couple with children where the husband worked outside the home and the wife worked in the home raising the children and doing the housework.[32] Slowly, however, the picture changed. In 1966, 92 per cent of families comprised of a husband and wife but by 1976 that figure had decreased to 90 per cent.[33] In addition to a decrease in the number of marriages, changes also occurred in the demographics of the labour force. One significant change was that more women began to work outside the home. In 1966, 27 per cent of married women worked outside the home. By 1976 that figure had increased to 44 per cent and by 1989 to 62 per cent signaling a huge change in the work patterns within the family.[34] It is important to note, however, that while there are more dual earner families than ever before, one reason for this demographic change is economic necessity. It has been estimated that, for example, in 1991 the percentage of couples living below the poverty line in dual earner families would have been 17.9% instead of 4.6% if women did not work in the paid labour force.[35]

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[31] Pierre Turcotte and Alain Belanger, *The Dynamics of Formation and Dissolution of First Common-Law Unions in Canada*, (Statistics Canada: <http://www.statcan.ca/english/research/other9.htm> at 1.

[32] See John F. Conway, *The Canadian Family in Crisis* (James Lorimer: Toronto, 1993) at 14. He notes that in 1941 only 4.5% of married women worked outside the home and while that figure did increase during the Second World War, it fell back again in the post-war years before increasing significantly in late 1950s and early 1960s.

[33] *Ibid.* at 18.

[34] *Ibid.* at 18 and 21.

These changes in labour force participation have been accompanied by a decrease in the number of people living in the nuclear family. Marriage rates continue to decline with the proportion of married couples falling in every province between 1991 and 1996[36] and while heterosexual couples are increasingly choosing common law status over marriage, the number of individuals living in either a marriage or a heterosexual common law relationship declined between 1991 and 1996.[37] At the same time the number of lone parent families in Canada is on the increase with women predominantly heading these families.[38] Indeed lone parent families headed by women outnumber those headed by men by more than four to one.[39] Aboriginal women and women of colour are more likely to be lone parents than white women.[40] Single mothers with children are disproportionately represented among the poor.[41] More women than ever before are living alone and fewer women are living in relationships with men.[42] Finally, the state has recently begun to recognize lesbian and gay relationships, as evidenced by the passage through the House of Commons of the *Modernization of Benefits and Obligations Act.*[43] That legislation extends to lesbian and gay couples the application of legal benefits and obligations of heterosexual common law spouses in sixty-eight statutes, including the *Income Tax Act.*

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[35] See, Statistics Canada, *Characteristics of Dual-Earner Families 1993*, Catalogue 13-215, (Ottawa: Statistics Canada, 1995) at 8.

[36] See, Statistics Canada, "1996 Census: Marital Status, Common-law Unions and Families" *The Daily*, Catalogue 11-00IE (October 14, 1997) at 4.

[37] *Ibid.* at 8.

[38] *Ibid.* at 2.

[39] *Ibid.*

[40] For example, almost 15 per cent of all Aboriginal women over the age of 15 and almost 18 per cent of all women of colour over the age of 15 are lone parents in contrast to 7 per cent of all white women over the age of 15. See, Statistics Canada, *Lone-Parent Families in Canada*, Catalogue 89-522E, December 1992, Table 1.9.

[41] In 1997 56 per cent of female headed lone parent families lived in poverty, Statistics Canada, *Income Distributions by Size in Canada, 1997* (Catalogue 13-207-XPB, July 1999) at 34-35 and Text Table IV. See also p. 187 and Table 67.

[42] Statistics Canada, *supra* note 36 at 2 and 6.

Taken together, the changing demographics described above raise the important issue of whether it remains appropriate to recognize relationships based on marriage and common law status in the tax system. Underlying this issue is the dissonance between the view of women as dependent on men for their financial well-being as espoused in the Act and the socio-economic realities of women's lives which increasingly see them as single and participating in the paid labour force. This report will explore these matters in detail and endeavour to put forward some suggestions for change to the Act that will alleviate some of the problems posed by outdated tax policies in the new millennium.

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[43] Bill C-23, *The Modernization of Benefits and Obligations Act*, as passed by the House of Commons on April 11, 2000.

CHAPTER TWO

TAX RECOGNITION OF SPOUSAL AND FAMILIAL RELATIONSHIPS

This Chapter sets the scene for the detailed analysis of the tax rules that recognize spousal and familial relationships. The intention is to provide a background to, and a context for, the rules that will be discussed in more detail in Chapter Three. To that end, this Chapter opens with a review of the short-lived proposal of the Royal Commission on Taxation (the Carter Commission) to change the unit of taxation to the family unit.[44] The Chapter then moves to a detailed legislative history of some of the more important provisions that take spousal and familial relationships into account. In particular, the historical analysis traces the evolution of key provisions such as the spousal tax credit, the attribution rules, the definition of spouse, the rollover of certain properties to a spouse or child and the principal residence exemption.[45] The statutory provisions on which this legislative history is based are contained in Appendix B to this report.

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[44] Government of Canada, *Report of the Royal Commission on Taxation*, (Ottawa: Government of Canada, 1966). The family unit proposed by the Carter Commission was to consist of husband and wife and, if there were dependent children, they would also form part of the family unit.

[45] The term "rollover" applies to the transfer of property on a tax-free basis. In effect, even though the transfer might give rise to a taxable capital gain, the proceeds of disposition in respect of the transfer are deemed to be an amount equal to the original cost of the property to the transferor. The transferee acquires the property with a cost equal to the same amount. The result is that tax on any accrued gain prior to the transfer is deferred until the transferee disposes of the property. The Act provides for the rollover of certain properties between spouses and between a taxpayer and their child.

The second part of this Chapter outlines and explains the method of classification of the rules that relate to "spouse", "married person" and "child". (See Appendix A for the classification of every provision that relates to spouse, married person or child in the Act.) Obviously any such classification is somewhat arbitrary but the analysis sets out the rationale underlying the grouping of the various provisions. The classification of the rules is key to the analysis and critique of the rules that form the basis of Chapter Three.

I. BACKGROUND

As already mentioned, the individual has always been the unit of taxation in Canada, although the integrity of that policy has been undermined by the rules that look to spousal and familial relationships. In 1966 the Carter Commission published its comprehensive *Report on Taxation* and recommended that the individual be abandoned as the tax unit and replaced by the family. It also recommended a joint system of filing for aggregated family income that would be subject to special rates. The Commission justified these recommendations on several grounds. For example, the Report states that

> the family is today, as it has been for many centuries, the basic economic unit in society. Although few marriages are entered into for purely financial reasons, it is the continued income and financial position of the family which is ordinarily of primary concern, not the income and financial position of the individual members. Thus, the married couple itself adopts the economic concept of the family as the income unit from the outset.[46]

Another reason given for recommending this dramatic change to the family as the unit of taxation was the perceived economies of scale that arise when two people (presumably only those in the same family) live together and therefore share expenses. The Commission took the view that the tax burden should be higher for the family unit than it is for two individuals because the members of a family living together do not spend as much as two separate individuals on household goods and other related expenses. The Commission also justified the recommendation on the basis of equity considerations. It was concerned that horizontal equity is offended by taxation based on the individual as the tax unit. This inequity arises when progressive tax rates (such as those which we have in Canada) are applied in computing the tax liability. Two families with the same total amount of income may have very different tax burdens depending on how the income of each family is split between the family members. The family in which both spouses have relatively equal incomes will pay less tax than a family with the same total amount of income but in which the income is earned by only one spouse. The reason is that the spouse who earns all the income will be taxed at a higher marginal tax rate than the two lower income spouses. Other reasons given for favouring the family as the unit of taxation were that the tax system would be simpler and easier to administer. If the family was the tax unit there would be no need for attribution rules and the tax system would be indifferent to transfers of property between spouses, obviating the need for the rollover provisions. Several commentators have pointed out that in making these recommendations the Commission totally ignored the impact of such measures on women[47] and that the recommendations were based on a "feudal" notion of economic relations within the family.[48]

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[46] Carter Commission, *supra* note 44, Volume 3 at 123.

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[47] Kathleen Lahey, *The Taxation of Women in Canada, A Research Report* (Faculty of Law, Queens University, 1988, unpublished report) at 53 and Neil Brooks, "The Irrelevance of Conjugal Relationships in Assessing Tax Liability" in Richard Krever and John Head eds., *Tax Units and the Tax Rate Scale* (Melbourne: Australian Tax Research Foundation, 1996) at 40.

[48] Lahey, *ibid.* at 56.

In fact, the recommendations of the Carter Commission on this issue were not adopted by the government and the 1972 tax reform did not change the unit of taxation from the individual to the family. One reason given by the government for not adopting the family unit was that such a system would have imposed a "marriage tax" because two spouses would pay more tax than two individuals with the same amount of income. The "marriage" tax would arise because in a system with progressive marginal tax rates aggregation of family income would often mean that the income of the family would be taxed at a higher marginal rate than it would be without the aggregation. It is, however, important to note that even though the 1972 tax reform did not change the tax unit to the family, it did retain all the rules that had previously treated spouses as one for several purposes and added some new rules in this regard.[49] Over the years most of these rules have been retained, although a few of the less important rules that look to the spousal unit have been repealed.[50]

Underlying the debate about the relevance of spousal relationships to the imposition of tax liability, is the issue of whether one takes the view that individuals should be taxed on the income that they control or the income from which they benefit. If you believe that individuals should be taxed on the income from which they benefit, then a corollary to that belief is that where an individual has a sharing relationship with another, the value of the economic resources from which the individual benefits through the sharing should be included in their income. When this theory is transposed to spousal relationships, the conclusion is that because spouses share their economic resources (a significant assumption), their incomes should be aggregated (and then divided between them) to determine their individual tax liability. Such a measure would be joint taxation of spouses. While we do not have joint taxation of spouses in Canada, the rules that look to spousal relationships are based on an underlying theory that spouses do share economic resources and that there is an economic mutuality to the relationship. Such rules are based on the benefit theory. The weakness of the benefit theory is that it assumes that there is pooling within the spousal relationship of income and wealth. As I discuss in Chapter Three, this assumption is highly flawed.

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[49] Sections 70(6) and 73(1) were added to the Act, effective January 1, 1972. These rules provide for a rollover of capital property to a spouse and became necessary because in 1972 capital gains became subject to tax for the first time in Canada with the introduction of a provision that required half of any capital gain to be included in income.

[50] The rules that have been repealed include the prohibition on the deduction of a salary expenses paid by one spouse to another, the ministerial discretion to allocate all or part of the income of a partnership of spouses to one or the other of the spouses and the application of the attribution rules to transfers between spouses that take place at fair market value. See, Jack London, "The Impact of Changing Perceptions of Social Equity on Tax Policy: The Marital Tax Unit", (1988) 26 *Osgoode Hall Law Journal* 287 at 297-298.

Meanwhile those who subscribe to the control theory would argue that the tax system should impose tax on the individual who controls the income, and therefore spousal or other relationships are irrelevant. The individual is and should remain the tax unit. As Neil Brooks has said

> Individuals should be taxed on the income they control, whether they share it with another or not. Thus taxpayers' conjugal, or any other sharing relationships, should be ignored in assessing their tax liability.[51]

The importance of the control theory of taxation is discussed later in Chapter Three when those provisions that are based on and assume an economic mutuality within a spousal or familial relationship are considered.

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[51] Brooks, *supra* note 47 at 47.

II. LEGISLATIVE HISTORY OF THE RECOGNITION OF SPOUSAL RELATIONSHIPS

A. Introduction

From the date of its inception in 1917, the Canadian income tax system has always taken account of certain aspects of spousal and familial relationships. While the nature of the relationship that is recognized by the Act, and the rules that apply to related persons, such as spouses, have changed over the years, the system has always treated married persons in a different manner than single persons. This Chapter will trace the legislative history of some of the most important provisions that currently apply to spouses. The purpose of this attention to history is to set the scene for the detailed classification and analysis of all the rules that apply to spouses.

The *Income War Tax Act*[52] (the predecessor of the current Act) provided a different tax threshold for married persons than it did for single persons. In particular, it imposed a 4 per cent tax on all income exceeding $1,500 for "unmarried persons and widows or widowers without dependent children".[53] For all other persons the 4 per cent tax was only payable on income exceeding $3,000. Therefore, from the very beginning, while the tax unit was the individual, married persons received preferential tax treatment by way of an exemption from tax. In fact, as Kathleen Lahey has demonstrated this policy "effectively exempted working class men--- single or married--- from income taxation.[54] The original tax legislation also included an attribution rule that was intended to stop income splitting between husband and wife. The broad rule[55] provided that where a person transferred any property to their husband or wife or to any member of their husband or wife's family, the person would be taxed as if the transfer had not been made, unless the Minister was satisfied that the transfer was not made for the purpose of evading tax. These two rules were the only provisions in the original income tax legislation that departed from the policy of the individual as the unit of taxation, but they laid the groundwork for the myriad of rules that take spousal relationships into account in the current income tax system.

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[52] *Income War Tax Act*, 1917, 7-8 Geo. V, c. 28.

[53] *Ibid.*, section 4(1)(a). It should be noted that in 1919, the provision was amended to change the amount of the exemption and the range of persons to whom it applied. The tax was imposed on income exceeding $1,000 but less than $6,000 for unmarried persons, widows and widowers without dependent children, and persons not supporting dependent brothers or sisters or sisters under the age of 18 or a dependent parent or grandparent. For all other

B. Spousal exemption \ tax credit

The exemption from tax for married persons is now formulated as a spousal tax credit, although the policy underlying the rule is the same as that which underlay the original exemption from tax for married persons. Both the exemption from tax and the current spousal tax credit recognize economic dependence in a relationship. In 1917, it was highly unlikely that women would work outside the home and in most instances they were dependent on men, whether their husbands or their fathers, for their economic security. At the same time husband and wife were viewed as one person with an underlying assumption that the husband would support the wife. While the role of women

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persons, the tax was imposed on income over $2,000 but not exceeding $6,000. See, *An Act to Amend the Income War Tax Act*, S.C. 1919, c.55, section 3.

[54] Lahey, *supra* note 47 at 378.

in society has changed over the years with more women than ever working outside the home, the current spousal tax credit remains based on economic dependence and is only available to taxpayers who support a spouse who is economically dependent upon the taxpayer.

By 1926, there was concern that while the exemption for married persons was intended to recognize economic dependence, it did not specifically state that it was only available where one spouse was economically dependent on the other. Consequently, the *Income War Tax Act* was amended to provide that the marriage exemption could only be claimed by a taxpayer whose spouse had income of less than $1,500 in the year.[56] By 1942, the amount that could be earned by the economically dependent husband or wife had dropped to $660. In 1942, the government removed the limitation on the amount that could be earned and provided that "a husband shall not lose his right to be taxed under Rule One of this section by reason of his wife being employed and receiving any income."[57] What is especially interesting about this amendment is that it was clearly designed to encourage women to participate in the paid labour force. They could now earn income without affecting their husband's entitlement to the married persons exemption. The removal of the limit on earnings was a gender specific measure because it only removed the limit on earnings and the dependency requirement in respect of wives. But this state of affairs did not last long. The next year the earnings limit was re-

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[55] *Supra* note 52, section 4(4).

[56] *An Act to Amend the Income War Tax Act*, 1917, S.C. 1926, c.10, section 4, adding subsection (1B). For a fascinating analysis of the background to the change to the married person's exemption, see Lahey, *supra* note 47 at 381-383.

[57] *An Act to Amend the Income War Tax Act*, 1917, S.C. 1942, c.28, section 1 which added section 1, Rule 3 to the Act.

instated at the lower amount of $250.[58] The next major change to the married person's exemption was its conversion to a tax credit in 1988.[59] The conversion to a tax credit means that the value of the credit no longer depends on the marginal tax rate of the taxpayer. Instead the credit is worth the same to all taxpayers regardless of their level of income.

C. Attribution rules

The inclusion of anti-avoidance rules, such as the original attribution rule, is a policy that has been continued and developed over the years. The 1917 attribution rule recognized that there was an incentive to split income and reduce the overall tax liability within relationships. At that time, this incentive arose where one spouse paid tax and the other did not pay tax. It was determined that the consequent tax advantage gained by the couple who transferred income to the spouse who did not pay tax was inappropriate. By the time of the 1972 tax reform, the rules had evolved into a more detailed series of rules that applied to all transfers of income producing property by taxpayers to their spouses or their minor children. The rules with respect to spouses attributed income and capital gains from property transferred to a spouse while the rules that applied to minor children only attributed income from the property. Over the years questions of interpretation concerning the application of the rules were resolved not by legislative amendment but by the courts.[60] Effective May, 1985 significant changes were made to the attribution rules which extended their application to all minors who did not deal at arm's length with the transferor and minor nieces and nephews. The new rules also expanded the application of the rules to interest-free or low-interest loans of property to a spouse or minor. In short, the previous more general rules were replaced with a detailed statutory code of application. The current rules, while based on the same premise as the original attribution rules, are significantly more complex than their predecessors and are discussed in detail in Chapter Three.

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[58] For a detailed analysis of the reasons for these changes, see Lahey, *supra* note 47 at 383-388. She theorizes that the re-instatement of the dependency requirement and its consequent disincentives to women's participation in the paid labour force was a deliberate policy intended to free up jobs for soldiers returning from war.

[59] Section 92(1) of *An Act to Amend the Income Tax Act*, S.C. 1988, c. 55.

D. Definition of spouse

The Act has never defined the terms "married person", "husband" and "wife". In the 1980s and early 1990s those terms were phased out of the Act and replaced with the word "spouse". Again, however, the Act did not define that term,[61] although it did include an extended definition of spouse that provided that "spouse" or "former spouse" included a party to a voidable or void marriage.[62] It was not until 1990 that heterosexual "common law" spouses were included in the Act and that inclusion was only for very limited purposes related to Registered Retirement Savings Plans.[63] It was the 1992 budget that proposed the expansion of the concept of spouse to include heterosexual common law spouses and effective January 1, 1993 section 252(4) was added to the Act.[64] Put simply, a spouse of a taxpayer is a person of the opposite sex who has cohabited with the taxpayer in a conjugal relationship for at least 12 months or who cohabits with the taxpayer in a conjugal relationship and who is a parent of a child of whom the taxpayer is also a parent. It is important to note that when this change was made, one consequence was a tax windfall of $985 million for the federal government over the five-year period following the change.[65] The main reason for this result was the decreased entitlement for many individuals to the GST tax credit and the Child Tax Credit by reason of the combination of the individuals' income because the entitlement to and the amount of these tax credits is based on "family" income.

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[60] See, for example, *Estate of David Fasken* v. *M.N.R.* [1948] CTC 265 which held that a divestiture of property by the transferor and a vesting of the property in a transferee was a transfer and *Sachs* v. *The Queen* [1980] CTC 358 which held that property includes a contingent interest in a trust.

[61] See, David Sherman, "Till Tax Do Us Part: The New Definition of 'Spouse'", *1992 Conference Report* (Toronto: Canadian Tax Foundation, 1992) at 20:2 where he states that spouse "takes on the meaning that it has at law generally: either of a husband and wife who has gone through a legal marriage ceremony performed by an authorized clergyman (sic) or official and permitted by the jurisdiction in which it takes place, and who have not been divorced."

[62] Section 252(3) of the Act was added by S.C. 1980-81-82-83, c.140, section 130(1), applicable after 1981.

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[63] Section 13(6) of *An Act to Amend the Income Tax Act*, S.C. 1990, c.35 added section 146(1.1) to the Act. Section 146(1.1) provided that a spouse of an individual included a person of the opposite sex married to the individual or who was cohabiting with the individual in a conjugal relationship and had so cohabited for at least one year or who is the parent of a child of whom the individual was also a parent. The section only applied for the purpose of certain definitions related to RRSPs although it did not, for example permit the establishment of spousal RRSPs for common law spouses. Rather the rules related to the ability to pass RRSP contributions of a deceased taxpayer to their common law spouse on a tax-free basis provided the spouse transferred the contributions to their own RRSP.

[64] Section 252(4) of the Act currently reads as follows:

> In this Act,
>
> (a) words referring to a spouse at any time of a taxpayer include the person of the opposite sex who cohabits at that time with the taxpayer in a conjugal relationship and
>
> (i) has so cohabited with the taxpayer throughout a 12 month period ending before that time, or
>
> (ii) would be a parent of a child of whom the taxpayer would be a parent, if this Act were read without reference to paragraph (1)(e) and subparagraph (2)(a)(iii)
>
> and for the purposes of this paragraph, where at any time a taxpayer and the person cohabit in a conjugal relationship, they shall, at any particular time after that time, be deemed to be cohabiting in a conjugal relationship unless they were not cohabiting at the particular time for a period of at least 90 days that includes the particular time because of a breakdown of their conjugal relationship:
>
> (b) references to marriage shall be read as if a conjugal relationship between 2 individuals who are, because of paragraph (a), spouses of each other were a marriage;
>
> (c) provisions that apply to a person who is married apply to a person who is, because of paragraph (a), a spouse of the taxpayer; and
>
> (d) provisions that apply to a person who is unmarried do not apply to a person who is, because of paragraph (a), a spouse of the taxpayer.

[65] Sherman, *supra*, note 61 at 20:7.

Historically, the Act has always excluded same-sex couples from the definition of spouse. A major breakthrough in this regard occurred in 1998 when the Ontario Court of Appeal held in *Rosenberg* v. *Canada (Attorney General)*[66] that the definition of spouse in the Act, as it applied to occupational pension plans, discriminated against lesbians and gay men on the basis of sexual orientation in contravention of section 15(1) of the *Charter of Rights and Freedoms.* The court also held that the discrimination could not be justified under section 1 of the Charter. The remedy granted by the court was to read the words "or the same sex" into the definition of spouse in section 252(4) of the Act, for the purposes of the registration of occupational pension plans. This ruling effectively extended entitlement to survivor benefits under occupational pension plans to the partners of lesbians and gay men who died while covered by the pension plan. The decision, however, did not affect the definition of spouse as it applied for any other purpose of the Act.

The federal government did not appeal the *Rosenberg* decision, signaling that the inclusion of lesbians and gay couples as spouses under the Act was imminent. In February 2000, the federal government introduced Bill C-23, *The Modernization of Benefits and Obligations Act.* That Bill, which proposed amendments to the Act that would include same-sex couples as spouses for all purposes under the Act, was passed by the House of Commons on April 11, 2000 and is now before the Senate. It is important to note that this change also results in the repeal of the current definition of "spouse" in the Act and its replacement by a new definition of "common-law partner".[67] There is a consequential provision that changes every reference in the Act to "spouse" or "spouses" to "spouse or common-law partner" and "spouses and common-law partners".[68] The consequence of these changes is that "spouse" will now refer only to married persons (as it did prior to the inclusion of common-law couples as spouses in 1993) and heterosexual common-law couples will be included in a separate category along with same-sex couples as common-law partners. To date, there is no indication that further amendments will be made which would result in a different application of the tax rules to married persons than to common-law spouses, but certainly the framework to make such changes is in place.

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[66] (1998), 98 D.T.C. 6286 (Ont. C.A.) [hereinafter *Rosenberg*].

E. Rollover provisions

Prior to the 1972 tax reform, capital gains arising on disposition of capital property were not subject to income tax. As a result of the recommendations of the Carter Commission and the tax reform process, effective January 1, 1972 one-half of a capital gain was required to be included in income of a taxpayer. At that time capital gains arising from several transactions were excluded from this requirement, including transactions in respect of capital property transferred by husbands and wives to each other. Sections 70(6) and 73(1) provided that a transfer of capital property by a taxpayer to their spouse either on death or on an *inter vivos* basis would effectively take place on a tax-free basis. The taxpayer would be deemed to dispose of the property and receive proceeds of disposition equal to their original cost of the property and the spouse would receive the property with a cost equal to the deemed proceeds of disposition. The result of these rules was a deferral of tax until the spouse disposed of the capital property.

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[67] Section 138 of the *Modernization of Benefits and Obligations Act* repeals section 252(4) (the current definition of spouse) and adds the following to section 248(1) of the *Act*:

> "common-law partner", with respect to a taxpayer at any time, means a person who cohabits at that time in a conjugal relationship with the taxpayer and
>
> (a) has so cohabited with the taxpayer for a continuous period of at least one year, or
>
> (b) would be the parent of a child of whom the taxpayer is a parent, if this Act were read without reference to paragraphs 252(1)(c) and (e) and subparagraph 252(2)(a)(iii),
>
> and, for the purposes of this definition, where at any time the taxpayer and the person cohabit in a conjugal relationship, they are, at any particular time after that time, deemed to be cohabiting at a particular time for a period of at least 90 days that includes the particular time because of the breakdown of their conjugal relationship.

A definition of "common-law partnership" being a relationship between two persons who are common-law partners of each other is also added to the Act.

[68] *Ibid.*, Schedule 2, section 142.

It is important to note that had the Carter Commission recommendation that the family be the unit of taxation been adopted, there would have been no need for the rollover rules because a tax system with the family as the unit of taxation is indifferent to intra-family transfers of property.

III. CLASSIFICATION OF PROVISIONS THAT REFER TO "SPOUSE", "MARRIED PERSON" AND "CHILD"

In their analysis of the tax rules that relate to spouses and familial relationships, several authors have divided the rules that relate to spouses into two categories, that is those rules which favour the spouses by giving them a reduced tax liability and those rules that are unfavourable to the spouses because they increase their overall tax liability.[69] Such an approach is, for the purposes of this report, not appropriate. It is far too simplistic and does not allow for a full analysis of the policy underlying the various provisions. One cannot judge the fairness of, or indeed the need for, a particular measure solely by criteria that look only at whether the taxpayer has an increased or a diminished tax burden. The rules that relate to spousal and familial relationships must be considered as part of a tax system that, as discussed in the previous Chapter, has many different purposes and goals. Any analysis of the rules must be situated both in the social and economic context in which the rules operate and it must take an approach that recognizes the importance of ensuring that the rules operate fairly. Fairness, as mentioned in the previous Chapter, encompasses the tenets of traditional tax policy analysis as well as the concept of equality.

Some authors have taken a more sophisticated approach in theorizing about the impact of, and need for, special rules that apply to spouses. For example Maureen Maloney uses five categories in her analysis for the Ontario Fair Tax Commission of "provisions that recognize a marital unit".[70] Her first category is affirmative-action provisions, that is those provisions that help to address the discrimination that men and women encounter in certain situations such as their ability to participate in the paid labour force. The child-care expense deduction is an example of an affirmative-action provision because it is intended to assist women with children entering the paid labour force. Secondly are those provisions that "reflect a popular image of 'family' in which the woman (typically) is dependent upon the man" such as the spousal tax credit.[71] Thirdly, Maloney categorizes several provisions, including the rules that allow the rollover of capital property from taxpayers to their spouses, as the "economic mutuality provisions". The fourth category is comprised of anti-avoidance rules such as the attribution rules. Finally, Maloney places several rules such as the child tax credit in a category that she describes as "welfare measures", that is those measures which can be viewed as an extension of the welfare system.[72]

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[69] For example, see Sherman, *supra* note 61 at 20:9 to 20:23 and Albert Wakkary, "Assessing the Impact of Changing Marital Rights and Obligations: Practical Considerations" (2000) 17 *Canadian Journal of Family Law*, 200.

[70] Maureen Maloney, "What is the Appropriate Tax Unit for the 1990s and Beyond?" in Allan Maslove ed., *Issues in the Taxation of Individuals* (Toronto: University of Toronto Press and the Ontario Fair Tax Commission, 1994) at 133-142.

Neil Brooks takes a different and perhaps more irreverent approach. He has two categories for the provisions that look to spousal relationships in the Act. The first category is those rules that "Perniciously Deny the Autonomy of Women, Treat Them as Dependents, Assume They Always Share the Economic Interests of Their Husbands, Ignore their Social Realities, and Reinforce Their Role of Caregivers"[73] and the second is those rules that "Justifiably Recognize Some Commingling of Affairs Between Spouses, Some Pooling of Economic Resources, and Some Joint Decision-making".[74] While Brooks' first category is indeed reflective of the impact of the rules that he discusses, and his second category acknowledges the policy underlying certain provisions, the approach that I take in this report is more closely allied to that of Maloney. Unlike Brooks, my classification is not based directly on the impact of the rule but rather it looks at the many different tax policy rationales that have underlain the various provisions from their inception. In other words, my classification is based on the answer to the question "why was this provision enacted?"

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[71] *Ibid.* at 135.

[72] *Ibid.* at 140.

[73] Brooks, *supra* note 47 at 72.

[74] *Ibid.* at 76.

Consequently the provisions listed in Appendix A are classified in the following manner:

- Anti-avoidance rules that are intended to stop or dissuade taxpayers from reducing the amount of tax payable within the family or spousal unit by measures such as income splitting
- Administrative provisions that deal with issues such as the filing of tax returns
- Definitional provisions that define relevant terms
- Provisions that recognize economic dependency within the spousal or family unit, such as the spousal tax credit which provides a subsidy to an individual supporting a person who is economically dependent on the individual
- Provisions that recognize economies of scale that arise from two persons sharing expenses and that reduce entitlement to certain tax subsidies computed by reference to family or spousal income
- Provisions that are based on an assumption of economic mutuality, that provide a tax advantage and that are in respect of
    a) employment
    b) the family farm or family corporation
    c) corporations and business partnerships
    d) the family home
    e) the death of the taxpayer
    f) *inter vivos* transfers of property

g) health and education
h) retirement and pensions
i) divorce or separation
j) miscellaneous

- Provisions that are based on an assumption of economic mutuality, that operate to the disadvantage of the spouse because they result in an increase in tax liability and which are in respect of
    a) corporations and business activity
    b) the family home
    c) the disposition of capital property
    d) divorce or separation
    e) retirement and pensions
    f) miscellaneous
- Provisions that impose a joint liability on spouses, such as making them jointly and severally liable for tax owing in respect of property transferred between them
- Provisions that relate to spousal trusts
- Provisions that are consequential to other spousal and family provisions.

CHAPTER THREE

TAX RULES THAT APPLY TO SPOUSAL AND FAMILIAL RELATIONSHIPS

> Income tax legislation should not interfere in social relationships. For the state to enter the realm of marital or family units has underlying it a perpetuation of patriarchal values which are anachronistic and untenable in a society that is heading, somewhat hesitantly, into an era of equality.[75]

The purpose of this Chapter is to consider the role that the provisions of the *Income Tax Act* identified in Appendix A play, and to reflect on whether some of the rules should be removed from the Act because they operate unfairly or are no longer appropriate or necessary. The approach is as follows. First, I shall discuss, in detail, the operation of selected rules from the main classifications identified in Chapter Two. Space does not permit an examination of every provision included in the Act, although there is a short description of every such rule in Appendix A. Consequently, I have chosen those provisions that are representative of the provisions in the category in which they are included. In addition, the focus is on those provisions that have been the subject of most comment and debate in the literature. Secondly, I shall analyze the operation and impact of the selected provisions. There is no doubt that some of the strongest critiques of tax rules that apply to spousal relationships have come from the feminist literature.[76] I shall draw on that literature as well as other Canadian tax policy literature, including work by the Ontario Fair Tax Commission. Following the analysis and critique, I make suggestions for change. The purpose of this report is to permit an informed discussion of the policy options available with respect to the rules that take spousal and familial relationships into account.

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[75] Maureen Maloney, "Women and the Income Tax Act: Marriage, Motherhood, and Divorce" (1989) 3(1) *Canadian Journal of Women and the Law* 182 at 187.

[76] For a complete bibliography of feminist literature on taxation between 1980-1998 (in French) and 1988 to 1998 (in English), see Josée Bouchard, Susan B. Boyd and Elizabeth Sheehy,

I. ANTI AVOIDANCE RULES

As long as income is subject to progressive tax rates, there will be an advantage to taxpayers to split income. This is because a taxpayer can reduce tax payable by assigning income or transferring income producing property to a person who pays tax at a lower marginal rate than the taxpayer does. Furthermore, because the tax unit is the individual and there is no aggregation of the income of spouses or families, the assignment of income or the transfer or loan of income producing property within the spousal or family unit is an attractive method of income splitting because control of the income of income-producing property is retained within the unit. The attribution rules are designed to stop this splitting of unearned or investment income by a taxpayer with a spouse or minor with whom the taxpayer does not deal at arm's length (including nieces and nephews).[77]

Canadian Feminist Literature on Law: An Annotated Bibliography (Ottawa: Canadian Journal of Women and the Law and the University of Toronto Press, 1999) at 499-507.

[77] Some of the material in this section is drawn from Claire Young "The Attribution Rules: Their Uncertain Future in Light of Current Problems" (1987) 35 *Canadian Tax Journal* 275. In fact, despite the title of this article, the rules continue to exist very much as they were at the time the article was written. Evidently, their future was not as uncertain as the author considered it to be!

As mentioned in the previous Chapter, income attribution rules have been included in Canadian income tax legislation since the introduction of income tax in 1917. At that time the rules applied to transfers of property or assignments of income to a spouse or any other family member and they included a test of application that looked not only to the form of the transaction but also its purpose. Over the years the rules have evolved in a manner that has resulted in the very detailed current rules that attempt to anticipate every particular income splitting transaction that might be employed by taxpayers. Therefore the current rules are significantly more complicated than their predecessors, although their general intent remains the same.

Section 74.1 provides that income or loss from property transferred or loaned by an individual, either directly or indirectly, to or for the benefit of that individual's spouse or a minor[78] is attributed to the individual and is not included in the income of the spouse or minor. Taxable capital gains and allowable capital losses realized on the disposition of property transferred or loaned by an individual to the individual's spouse are also attributed to the individual, and not included in the computation of the spouse's income.[79] In each case, attribution applies to income, gains or losses from the original property or substituted property. There is no attribution once the individual transferor or lender ceases to be a resident of Canada or is no longer alive. In the case of a transfer or loan to a spouse, there is no attribution of income or loss once the spouses are separated or divorced and no attribution of capital gains or losses realized after the separation or divorce if a joint election is made by the transferor or lender and the spouse or former spouse.[80] There are two significant exceptions to the rules. The first is in respect of loans that bear a commercial rate of interest. If interest is charged at a rate not less than the rate prescribed by regulation or the rate to which arm's length parties would have agreed and if that interest is paid within 30 days after the end of each year, the attribution rules do not apply to the income, gains or losses.[81] The second exception is for transfers to a spouse or minor which are made at fair market value, although in order for this exception to apply the spouses would have to elect out of the automatic rollover under section 73(1) of the Act.

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[78] In this context minor refers to a minor with whom the taxpayer does not deal at arm's length and also includes nieces and nephews. Because this report focuses on references to "spouse" and "child", the material on the attribution rules will consider the impact of the rules as they apply to those two groups only.

[79] Section 74.2 of the Act.

The attribution rules contain a myriad of provisions that are intended to make sure that they apply to every transaction that is considered inappropriate income splitting and tax avoidance. These transactions include the use of back-to-back loans, guarantees, trusts and other devices to circumvent the ambit of the rules. It should also be noted that the rules described above are part of a comprehensive set of provisions that apply to income splitting and tax avoidance generally. Therefore there are other more general attribution rules that also apply to spouses, although their application is broader than the attribution rules described above because they apply to a broader range of persons. Rules such as those contained in section 56(2) and (4) would apply to the diversion of income to a spouse or child, because they apply to the diversion of income to any person and to a non-arm's length person respectively. Section 56(4.1) applies to an interest-free or low interest loan made to a non-arm's length person. Because these rules do not include a direct reference to "spouse" or "child", they are not discussed in this report. Finally section 75.1 is an attribution rule intended to prevent the diversion of gains in respect of farm property transferred to a child on a tax-free basis under section 73. This rule attributes any gain on the disposition of the property to the transferor if the child disposes of the property before attaining 18 years of age.

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[80] Section 74.5(3) of the Act.

[81] Section 74.5(2) of the Act.

An important issue is whether the attribution rules operate in a fair and effective manner and, if not, what are the problems that need to be addressed. Underlying these issues is the question of whether they should be repealed. Certainly there are complications when one tries to locate the attribution rules in the general scheme of all rules that apply to spouses. In their application to intra-spousal transactions, these rules appear to be in conflict with the policy underlying the rules that permit the transfer of property between spouses on a tax-free basis. As already mentioned, section 73(1) provides for the automatic rollover of capital property from one spouse to another at cost, thereby resulting in no capital gain or loss for the transferor and a deferral of tax on any gain until the transferee disposes of the property. The only way to avoid the automatic rollover is for the transferor to elect that subsection 73(1) will not apply to the transaction. The rollover rules treat spouses as one tax unit with respect to property transfers between them. Yet, if on a subsequent disposition of that property by the transferee, a capital gain or loss arises, it is not taxed jointly to both spouses as would be consistent with a policy that treats the spouses as one unit. Rather the gain or loss is attributed to the transferor on the basis that the individual is the tax unit and cannot rearrange their affairs within the spousal unit to reduce their tax burden.

There is a second issue that arises as a result of the interaction of the section 73(1) rollover to a spouse and the attribution rules. In order for the attribution rules not to apply to income generated by capital property transferred to a spouse or a capital gain on disposition of the capital property, the property must be transferred at fair market value. Such a rule means that the transferor must elect out of section 73(1) and thereby lose the advantage of the rollover. Consequently the rule in section 73(1) and the attribution rules appear to deliver rather inconsistent messages. Section 73 encourages the transfer of capital property to a spouse by permitting the transfer to take place on a tax-free basis while the attribution rules discourage the transfer unless it is made at fair market value, meaning that the spouse acquiring the property needs to secure the funds to pay for the property.

There is another inconsistency in the application of the attribution rules. The splitting of property income with an adult child or indeed a related adult, other than one's spouse, is acceptable. What is not acceptable is splitting property income within the family unit with a spouse or child. If one assumes that the rules denying the benefits of income splitting exist to preserve the individual as the tax unit and to eliminate any advantage from the diversion of income, then the attribution rules cannot be justified on this basis alone. They apply in limited circumstances and can be justified only on more pragmatic grounds. That is, it is undesirable to allow the splitting of property income within the relationship where it is most likely to occur, the family. Furthermore, they apply only to two relationships within the family, that between an adult and a minor child and that between spouses. It is therefore very difficult to justify the existence of the attribution rules by reference to tax policy criteria such as equity.

Another critique of the attribution rules is that "the rule fails to recognise the autonomy of the spouse receiving the property (usually the wife)".[82] This problem arises because the income is treated as if it were the income of the other spouse. A related issue is whether these rules act as a deterrent to the transfer of property between spouses and, in particular, by a more well off spouse to a spouse with little or no property or income. This is a gender issue given that men tend to own more property and have greater incomes than women, and the attribution rules are encouraging them not to transfer their property or after-tax income to their spouses. This problem hinders the redistribution of wealth and income between men and women. The issue of whether, in the absence of the attribution rules, men would transfer more property to their spouses is an empirical one on which there is no data. Maureen Maloney has speculated that repeal of the attribution rules might have the effect of encouraging transfers of property between spouses. She points out that before the rules were amended in 1981 to "restrict the principal residence capital gains exemption to one house per family, many second homes were transferred to the sole ownership of the wife".[83]

The attribution rules play a unique role in the legislative attack on income splitting. They are the only rules that have always been directed primarily at income splitting within the family. As such, they are based on the assumption that individuals who have spouses with little or no income will choose to transfer property to those spouses in order to reduce the tax payable on income or capital gains generated by that property.

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[82] Neil Brooks, "The Irrelevance of Conjugal Relationships in Assessing Tax Liability" in Richard Krever and John Head eds., *Tax Units and the Tax Rate Scale* (Melbourne: Australian Tax Research Foundation, 1996) at 74.

[83] Maureen Maloney, *Women and Tax Reform: Background Paper* (Ottawa: Canadian Advisory Council on the Status of Women, 1987) at 16. It should be noted, however, that no statistics about the increase in these transfers are included to support Maloney's assertion.

Unfortunately there is no empirical evidence that tells us whether this transfer of property is in fact happening in spousal relationships. Indeed one can speculate that given women's increased participation in the paid labour force and the increase in the number of two family earners, there is less opportunity for taxpayers to benefit from income splitting between spouses. Even if one spouse has a slightly higher income than the other and therefore there is, in theory, an advantage to be gained from transferring property to the lower income spouse, the transfer of that income generating property may mean that the lower income spouse's increase in income moves her to a higher tax bracket, thereby defeating the purpose of the transaction.

What is the cost, both in dollars and in terms of the damage to the integrity of the tax system, of repealing the attribution rules and thereby permitting the splitting of property income with a spouse or minor by way of loans or transfers of property? It was estimated in 1986 that the maximum tax saving achieved by a top marginal rate taxpayer from transferring income-producing property to a spouse with no other income was about $9,500 a year.[84] That figure included both federal and provincial taxes and was based on the transfer or loan of property generating income of $68,000 a year. In the case of income splitting with a minor, the tax saving may be a little more if the minor is a dependent because the amount of any dependent tax credit lost by the transferor or lender as a result of the increase in the minor's income is less than the amount of the spousal tax credit lost by reason of an increase in the spouse's income. Given that both the number of tax brackets and the tax rates have dropped since this calculation was made in 1986, one can assume that the saving today would be considerably less. Although the maximum potential tax saving for a taxpayer can be estimated, the number of taxpayers who, in the absence of rules designed to stop income splitting, would organize their affairs to take advantage of these tax savings is difficult to estimate. One cannot assume, for example, that all spousal couples in a financial position to benefit from income splitting would actually do so.[85] Non-tax factors, such as legal and other costs of transferring property or lending funds, the stability of the relationship, and any anticipated changes in the relative income of the spouses, may well deter many taxpayers from income splitting. Furthermore, many of those who would stand to benefit might not be aware of the advantages to be gained from the transfer or loan of income producing property. It is interesting to note that when the attribution rules were the subject of a major overhaul in 1985 that extended their application to loans among other transactions, the government did not give loss of revenue as a reason for their extension.[86]

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[84] Robert Dart and David Smith, "Estate Planning: A New Era" (1986) 34 *Canadian Tax Journal* 1 at 8-27.

The strongest argument in favour of retaining the attribution rules is that they play an important role in ensuring that our tax system is vertically equitable. As mentioned at the outset of this report, vertical equity means treating differently situated persons in appropriately different ways. One tool by which vertical equity is accomplished is the retention of progressive tax rates based on ability to pay. If the attribution rules are repealed it is those with the highest incomes who will benefit because they will be able to save tax by transferring income producing property to a spouse with little or no income. Neil Brooks deals with the tension between the benefit of a repeal to those with high incomes and the negative impact of the rules for many women this way:

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[85] The issue of the potential likelihood of persons to income split was addressed in Alan MacNaughton and Thomas Matthews, "Is the Income Splitting Tax Needed? Some Empirical Evidence" (1999) 47 *Canadian Tax Journal* 1164. In this article the authors evaluate the potential impact of the new "kiddie" tax, a series of rules introduced in the 1999 budget that propose that certain types of dividend and business income received by minors under 18 be taxed at the top marginal rate. They conclude that "[I]ncome splitting behaviour seems to be confined to a small segment of the population. In 1996, only 0.49 per cent of all individuals under age 20 reported dividend income and only 0.19 per cent reported net business income" at 1179.

[86] Young, *supra* note 77 at 298.

> Changing this rule and recognising bona fide transfers of property between spouses would benefit only middle- or high- income families with property. Nevertheless, recognising the autonomy of women for tax purposes is important, regardless of the distributive consequences across income classes.[87]

In conclusion, it is interesting to note that the issue of whether the attribution rules should be retained is not one that has received much discussion recently. There seems to be an assumption that because they have been part of the tax system since its inception, they should remain. For example, the Ontario Fair Tax Commission in its mammoth report on "Fair Taxation in a Changing World" did not discuss the attribution rules and neither did the Women and Tax Working Group of that Commission.[88] Given the problems discussed above and, in particular, the negative consequences for many women, it is time that these rules were reconsidered. The only strong argument for their retention is that they discourage income splitting by those with high incomes and therefore their repeal would only benefit that group. Without any empirical data, it is difficult to determine whether there would be a significant increase in income splitting in the absence of the rules. A related question is whether there would be a concomitant increase in the transfer of property by men to women that would have the advantage of addressing women's lack of income and wealth relative to men. Clearly more empirical research needs to be done before an informed decision about the consequences of repealing the attribution rules can be made.

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[87] Brooks, *supra* note 82 at 74.

[88] See Ontario Fair Tax Commission, *Fair Tax in a Changing World, A Report* (Toronto: University of Toronto Press in co-operation with the Ontario Fair Tax Commission, 1993) and Ontario Fair Tax Commission, Women and Taxation Working Group, *Women and Taxation* (Toronto: Ontario Fair Tax Commission, 1992).

II. ADMINISTRATIVE PROVISIONS

The administrative provisions listed in Appendix A relate to the substantive rules that apply to spousal and familial relationships. Whether these rules should be retained or repealed depends on the fate of the substantive rules to which the administrative provisions relate. Nevertheless, it is important to include the administrative provisions in Appendix A in order to present a comprehensive and complete list of all provisions that apply to spousal and familial relationships.

III. DEFINITIONAL PROVISIONS

The definitions listed in Appendix A are used in many of the provisions that relate to spousal and familial relationships. The most important definitions are the extended definition of "spouse", the extended definition of "child" and the definition of "related persons". It is important that the broad ambit of these definitions is recognized when considering the impact of the substantive rules to which they relate.

As already mentioned, section 252(4) of the Act defines a spouse to include a person of the opposite sex cohabiting in a conjugal relationship with another person where they have cohabited for a 12-month period or where they are the parents of a child. That definition will include same-sex relationships for the 2001 and subsequent taxation years.[89] Section 252(3) of the Act extends the definition of "spouse" and "former spouse" to include a party to a void or voidable marriage. But the extended definition of spouse has an impact that reaches even further. Section 252(2) of the Act provides that a parent of the taxpayer includes the parent of the taxpayer's spouse. A reference to a brother of the taxpayer includes a person who is the brother of the taxpayer's spouse or the spouse of the taxpayer's sister. Similarly, a reference to a sister of a taxpayer includes a person who is the sister of the taxpayer's spouse or the spouse of the taxpayer's brother. The section also provides that a grandparent of the taxpayer includes a person who is the grandparent of the taxpayer's spouse or the spouse of the taxpayer's grandparent. These rules effectively ensure that "in-law" relationships are caught, thereby extending the network of relationships that are relevant for tax purposes. At the same time the Act also has references to married persons, a relic of the time when common-law spouses were not recognized by the Act. Section 252(4) provides that provisions that apply to a person who is married apply to a person who is the spouse of the taxpayer. Finally section 251(2) of the Act provides that related persons (a term used frequently in the Act) are persons connected by blood, marriage or adoption and subsection (6) provides that persons are connected by marriage if one is married to the other or to a person who is connected by blood relationship to the other. It is beyond the scope of this report to discuss all the provisions that apply to related persons but it must be noted that the term includes spouses and their "in-laws".

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[89] It should be noted that Bill C-23, the *Modernization of Benefits and Obligations Act* also provides that persons in same-sex relationships who qualify as spouses under the new legislation may choose to be treated as spouses for the 1998, 1999 and 2000 taxation years.

Section 252(1) provides that a reference in the Act to "child" includes a person who is the natural born child of the taxpayer or an adopted child of the taxpayer. It also includes a person who is wholly dependent on the taxpayer for support and of whom the taxpayer has, before the individual attained 19 years of age, obtained custody or control. Therefore a child of a taxpayer is not limited to a person under 18 if that person is dependent on the taxpayer for their support and in the custody or control of the taxpayer. A child also includes a child of the taxpayer's spouse and the spouse of a child of the taxpayer. Thus, all spouses of taxpayer's children are considered to be a child of the taxpayer, thereby extending considerably the familial relationship.

The extended meanings of "spouse", "child" and "related persons" must be taken into account when considering the discussion in this report of the ambit of the rules that apply to spousal and familial relationships.

IV. PROVISIONS THAT RECOGNIZE DEPENDENCY

As I shall discuss, it is those provisions that are based on one person's economic dependence on another in a spousal or familial relationship that have been the subject of more critique in recent years than other rules that take spousal or familial relationships into account. The tax rules that look to economic dependency by one spouse on another that I discuss in this part include the spousal tax credit and the ability to pass unused tax credits to a spouse. I then turn to a discussion of those rules that provide a benefit in respect of a dependent child and my primary focus is the Canada Child Tax Benefit. My conclusion is that rules that look to economic dependence in spousal relationships should be repealed, while those that apply in respect of dependent children should be removed from the Act and replaced by a direct grant system that would deliver the tax subsidy in a more equitable manner.

A. Spouses

Section 118(1)(a) of the Act provides the spousal tax credit which is available to a taxpayer who supports a spouse. The maximum amount of the credit is $915 (17 per cent of the spousal amount of $5,380), and that spousal amount is reduced by the excess of the spouse's net income over $538. This reduction has the effect of eliminating entitlement to the credit when the spouse's income exceeds $5,918, meaning that if the spouse works in the paid labour force entitlement to the credit is lost very quickly. Related to the spousal credit are rules that an individual who is unable to use certain tax credits may transfer them to their spouse who may then apply them to reduce their tax payable. Credits eligible for this transfer include any unused portion of the tuition tax credit, the education tax credit, the age credit, the pension credit and the disability tax credit.[90] While neither the spousal tax credit nor the ability to pass unused tax credits to a spouse refer to "dependency", the provisions only apply when one person is economically dependent on the other. The spousal tax credit is available to a person who "supports" their spouse and entitlement to the credit disappears when the spouse earns a small amount of money. Similarly, the ability to transfer unused tax credits is dependent on one spouse having little or no income to which they can apply the tax credits.

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[90] Section 118.8 of the *Act*.

There is a gendered impact to these rules. More women than men work in the home and not in the paid labour force and therefore it is men who predominantly claim the spousal tax credit.[91] Furthermore, more than four times as many men use tax credits transferred from their spouse than women do.[92] Several issues arise when one considers the impact on women of provisions such as the spousal tax credit and the transfer of unused credits. The first issue is that provisions based on dependency are a disincentive to women's participation in the paid labour force. The theory is that when the tax costs (in this case the loss of the spousal credit and the inability to transfer unused credits to a spouse) are taken into account, there is a real disincentive to women in spousal relationships entering the paid labour force. This disincentive is exacerbated by other costs incurred by women who choose to work outside the home, such as child care costs, travel costs, clothing and the monetary and non-monetary costs associated with replacing the household labour. Furthermore, studies show that women's participation in the paid labour force is more elastic than that of men.[93] In other words, women as secondary earners tend to be more sensitive to any extra costs imposed on them (or their spouse), such as the costs associated with the loss of entitlement to the spousal tax credit. [94] Furthermore, when one considers that many women are the secondary earners in their relationships, and that they work for relatively low wages, the combination of these factors and the tax disincentives have a particularly detrimental effect on women's choice to work outside the home.

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[91] Unfortunately, tax statistics only show the gender breakdown of the amount received for the spousal tax credit and the equivalent to spousal tax credit as one calculation. The equivalent to spousal tax credit is given in respect of dependants such as children and therefore may likely be taken by more women than men, given that more women head lone parent families than men. Nevertheless, statistics for the 1996 taxation year show that more men than women claimed these two credits. See Government of Canada, *Income Statistics, 1998* (Ottawa: Department of National Revenue, 1998) at 103.

[92] See Government of Canada, *ibid.*

[93] Joseph Stiglitz, *Economics of the Public Sector* (New York: Norton, 1988).

Despite the disincentives to women's participation in the paid labour force and the elasticity of their participation, more women than ever are working outside the home.[95] The main reason appears to be economic necessity. In 1991 the percentage of couples living below the poverty line in dual earner families would have been 17.9% instead of 4.6% if women did not work in the paid labour force.[96] Women are not, however, earning what men are and they are more likely to be engaged in casual or part time work which often means that they continue to be the secondary earners in their relationships. In 1995, for example, the average total income for all Canadian women over 15 was roughly $16,600 while the corresponding figure for men was $29,600.[97] In 1997, women working full time earned an average of 72.5% of the earnings of men employed full-time for a year.[98] Women predominate in the part-time labour force. For example, between 1976 and 1991 women consistently represented at least 70% of part time workers.[99] In

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[94] On this issue see, S. Crompton and L. Geran, "Women as Main Wage-Earners" (1995) *Perspectives*, 26-29.

[95] In 1991, 56 per cent of married Canadian women were employed compared to 47 per cent in 1981, Nancy Ghalam, *Women in the Workplace* (Ottawa: Statistics Canada, 1993).

[96] See, Statistics Canada, *Characteristics of Dual-Earner Families 1993*, Catalogue 13-215, (Ottawa:Statistics Canada, 1995) at 8.

[97] Status of Women Canada, *Economic Gender Equality Indicators* (Catalogue SW21-17/1997E, October 1997) at 13.

[98] Monica Townson, *A Report Card on Women and Poverty* (Toronto: Canadian Centre for Policy Alternatives, 2000) at 4.

[99] Statistics Canada, *Women in Canada: A Statistical Report*, 3rd ed. (Ottawa: Minister of Industry, 1995) at 73.

1994 women held 69 per cent of all part time jobs and 26 per cent of employed women worked part time.[100] While some women cite personal and family responsibilities as the reason for working part time,[101] over one-third of women working part time are seeking full time work.[102] Therefore any added penalty to women's participation in the paid labour force is unacceptable.

Another important critique of dependency provisions is that rules like the spousal tax credit affirm that a woman's dependency on man deserves tax relief. Again, this undermines the autonomy of women and it results in a certain privatisation of economic responsibility for dependent persons. Tax policy has responded to women's lack of economic power by leaving it to the family (the private sector) to assume responsibility for women's lack of resources. Furthermore, in the case of the spousal tax credit, the tax subsidy is delivered to the economically dominant person in the relationship and not the 'dependent' person who needs it.[103] This manner of delivery assumes that income is pooled and wealth distributed equally within the relationship. However, as I shall discuss in greater detail in the next section of this Chapter considering the impact of those provisions based on economic mutuality, studies show that this assumption is simply false. In reality, such pooling and redistribution of wealth does not occur in the majority of relationships.[104] Many women do not have access to or control over income earned by their spouse and predicating tax policies on the assumption that they do is unfair.

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[100] Statistics Canada, *The Daily* <http://www.StatCan.ca/Daily/English/980317/d980317.htm> at 9.

[101] Statistics Canada, *supra* note 99 at 74.

[102] Canadian Labour Congress, *Women's Work: A Report* (Toronto: Canadian Labour Congress, 1997) at 25. See also, Townson *supra* note 98 at 5.

[103] On this issue see, Maloney "What is the Appropriate Tax Unit for the 1990s and Beyond?" in Allan Maslove ed., *Issues in the Taxation of Individuals* (Toronto: University of Toronto Press and the Ontario Fair Tax Commission, 1994) at 137.

It is interesting to note that the spousal tax credit is a measure that can be viewed as one that gives public recognition to the work done by women in the home. Indeed it is the only measure (tax or otherwise) that places a "value" on household labour. But if it is intended to recognise the contribution made by those who work in the home then, as mentioned above, the tax credit should go to the person who performs that labour and not the person who benefits from it. Further, viewing the tax credit as a measure that values household labour is problematic. Because the "value" placed on the labour is so low, the measure can only be considered to reinforce the perception that household labour, including child-care has little value. That in turn contributes to the under-valuation of work such as child-care, even when it is performed in the open market, as evidenced by the low salaries paid to child-care workers.

There is also clear evidence that the living arrangements of taxpayers have changed considerably since the introduction of provisions such as the spousal tax credit. The number of people living in traditional nuclear families is declining, more women than ever are living alone or with their children and the vast majority of lone-parent families are headed by women. Indeed lone parent families headed by women outnumber those headed by men by more than four to one.[105] As the Working Group of the Ontario Fair Tax Commission says "the concept of a couple as a life-long economic unit with joint income, wealth, and expenses may no longer be appropriate given changing family structures, increasing divorce rates, and falling marriage rates".[106] These changes must be taken into account when considering the future of measures such as the spousal tax credit and the ability to transfer unused credits to a spouse.

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[104] Harold Alderman, "Unitary Collective Models of the Household: Is it Time to Shift the Burden" *World Bank Research Observer* (1995) vol. 10 at 1, Neil Brooks, *supra* note 82 at 63, Marjorie Kornhauser, "Love, Money, and the IRS: Family, Income-Sharing, and the Joint Income Tax Return" (1993-94) 45 *Hastings Law Journal* 63-111, and Jan Pahl, "Personal Taxation, Social Security and Financial Arrangements Within Marriage" (1986) 13 *Journal of Law and Society*, 241-250.

As discussed in the historical analysis of the spousal tax credit in Chapter Two, the policy underlying this provision is the recognition of the reduced ability to pay tax of an individual who is supporting a person economically dependent on the individual. But this argument is not a persuasive justification for retention of the spousal tax credit and other tax preferences that reward economic dependence. As Neil Brooks has stated

> there is no reason why a person who voluntarily undertakes to support a spouse at home should be considered to have a reduced ability to pay. Certainly the control theory on income would suggest that this is an inappropriate deduction in terms of tax principles.[107]

Another problem with this rationale is that it ignores the benefit that accrues to the individual from work performed in the home, such as housework and child-care, by the person whom they support. Indeed this home labour may well increase the ability to pay of the individual because there is no need to have recourse to the private market in order to obtain the services provided in the home by the spouse who is supported by the individual. This point was not lost on the Royal Commission on the Status of Women in

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[105] Statistics Canada, "1996 Census: Marital Status, Common-law Unions and Families", *The Daily* Catalogue 11-001E (14 October 1997) at 2.

[106] Ontario Fair Tax Commission, Women and Taxation Working Group, *supra* note 88 at 9.

[107] Brooks, *supra* note 82 at 73.

1970 when it rejected the Carter Commission recommendation that the family be the unit of taxation. At that time the Royal Commission on the Status of Women noted that:

> In most cases the wife who works at home as a housekeeper, far from being a dependent, performs essential services worth at least as much to her as to her husband as the cost of food, shelter and clothing that he provides for her".[108]

The demeaning view of women's work in the home as non-productive work and the stigma attached to that work was one of the reasons that the Royal Commission on the Status of Women recommended that the amount of the spousal exemption (as it then was) be reduced considerably.

What measures might redress the problems discussed above? A first step would be to reconsider the general issue of providing tax subsidies such as the spousal tax credit to those in spousal relationships. For example, in the United States, economist Julie Nelson suggests that spousal status should not be the determinant of which relationships are relevant for the purposes of tax subsidies. She suggests the term should be expanded to include "individuals-in-relation" which would include the taxpayer and his or her dependant. A dependant would include a person unable to support himself or herself and the connection to the individual may or may not be a familial one.[109] The individual would claim the tax credit in respect of their support of the dependant. While this suggestion would factor in different kinds of living relationships, it would not address directly the problems of the disincentive to women's participation in the paid labour force, nor the fact that the subsidy is delivered to the economically dominant person in the relationship. More radical change is required.

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[108] Royal Commission on the Status of Women in Canada, *Report* (Ottawa: Information Canada, 1970) at 293-294.

[109] Julie Nelson, *Feminism, Objectivity and Economics* (New York: Routledge, 1996) at 108.

The Ontario Fair Tax Commission struggled with this issue. The Women and Tax Working Group was split in the approach to be taken. Some members recommended that the spousal tax credit and the rules respecting the transfer of unused credits be repealed.[110] In its final report, the Commission recommended that "[i]deally the marital credit should be removed at both the federal and provincial level" and the surplus funds redirected through a reformed credit process.[111] This approach is one that is also favoured by Maureen Maloney. She said:

> Dependency provisions should be eliminated. These provisions undermine the important contribution that women working in the home make to the economy. Equally important, they raise the costs of entering the workforce, thereby distorting their choices and undermining their autonomy.[112]

Given the problems discussed above, I believe that the spousal tax credit and the rules that permit the transfer of unused tax credits to a spouse should be repealed.

B. Children

The most important measure that recognises the economic dependency of children on their parents and that the support of children should be subsidised through the tax system is the Canada Child Tax Benefit. In 1945 the *Family Allowances Act*,[113] Canada's first universal welfare payment program, was enacted.[114] The espoused purpose of the program was to help redress the inadequacy of post-war wages by providing economic support to families with children. As Jane Ursel has commented "[f]amily allowances represented the compromise between capital and labour in its most naked form—subsidizing a wage system designed to ignore reproductive costs, only to perpetuate it".[115] In 1973 the *Income Tax Act* was amended to require the inclusion of family allowances in income.[116] While this measure was enacted in order to introduce some progressivity to the family allowance because individuals would be taxed at their marginal rate on amounts received, it also heralded the future demise of the universality of family allowances. Even though all taxpayers would receive the family allowance, the net after-tax value would vary depending on the taxpayer's marginal rate. In 1979 the federal refundable child tax credit was introduced, a measure that was intended, in part, to replace family allowance payments.[117] The child tax credit was tied to family income and the amount of the credit was reduced by 5% of the amount by which the income of the individual and the supporting person (usually the parents of the child) exceeded $18,000. The universality of the family allowances was extinguished in 1989 when the tax-back of family allowances was introduced. From 1989 until the family allowance system was abolished in 1992, a tax-back rate of 15% applied to taxpayers' net incomes over $50,000 and in two parent families, the tax-back was applied to the income of the taxpayer with the higher income in the relationship.[118]

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[110] Ontario Fair Tax Commission, Women and Tax Working Group, *supra* note 88 at III. Those members of the Women and Tax Working Group who did not favour repeal of these provisions did argue for the conversion of the spousal credit to a refundable tax credit that should be delivered to the spouse with the lower income. Such a measure would ensure that the economically dependent person in the relationship received the subsidy.

[111] Ontario Fair Tax Commission, *supra* note 88 at 271.

[112] Maloney, *supra* note 103 at 146.

[113] S.C. 1944-45, c.40.

[114] For detailed analyses of the family allowance program see, Dennis Guest, *The Emergence of Social Security in Canada*, 3rd ed. (Vancouver: UBC Press, 1997) and Jane Ursel, *Private*

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*Lives, Public Policy, 100 Years of State Intervention in the Family (*Toronto: Women's Press, 1992).

[115] Ursel, *ibid.* at 198. For an excellent analysis of the history of the family allowance, including the policies underlying its introduction, see Ursel at 190-198.

[116] *The Family Allowances Act,* S.C. 1973, c.44.

[117] *An Act to Amend the Income Tax Act to Provide for a Child Tax Credit and to amend the Family Allowances Act,* 1973 S.C. 1978-1979, c. 5.

[118] Family Allowances were repealed by S.C. 1992, c.48, s.31.

The original child tax benefit provided a basic benefit of $1,020 for each child which represented the amount of the maximum family allowance and the refundable child tax credit. There were supplements for families with more than two children and the full amount of the benefit was paid to families with income up to $25,921, and the amount of the benefit was gradually reduced for families with incomes above that amount. In addition there was an earned income supplement as an added incentive to low-income working families. There is no doubt that the child tax benefit was the subject of much criticism by social policy organisations and children's advocates. This critique was encapsulated by Ken Battle who said "[t]heir major criticisms concerned the new scheme's lack of protection from inflation, weak impact on family poverty, differential treatment of welfare and unemployed families, and lack of responsiveness to changes in family income, as well as its formal abolition of universal child benefits".[119]

The 1997 federal budget proposed changes to the child tax benefit and, effective July1, 1998, it was reincarnated as the Canada Child Tax Benefit (CCTB).[120] The CCTB includes a basic benefit and the National Child Benefit, which is a supplement for lower-income families (formerly the working income supplement). The CCTB is payable monthly to the parent who is the primary caregiver of the child and the amount of the payment is reduced and eventually eliminated as annual "family" income increases beyond a threshold limit, which for the 1999 taxation year is set at $27,750 and for the 2000 taxation year at $29,590. There is also a rebuttable presumption that the primary caregiver of the child is the "female parent", as the Act describes it.[121] From July 1999 onwards the amount of the basic benefit is $1,020 for the first child, supplemented by $785 per year for each child under 7 in respect of whom no child-care expenses are deducted under section 63 of the Act. For the year 2000 and on, the supplement increases to $955 for the first child. If child-care expenses are deducted, the amount of the supplemental amount is reduced by 25 per cent of the expenses deducted under section 63.

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[119] Ken Battle, "The Politics of Stealth: Child Benefits Under the Tories" in Susan D. Phillips ed., *How Ottawa Spends: A More Democratic Canada* (Ottawa: Carleton University Press, 1993) at 429.

[120] Section 122.6-122.64 of the Act.

Much has been written about the inadequacies of the Canada Child Tax Benefit[122] and I would suggest that these inadequacies have a particularly detrimental impact on women who are presumed by the Act to be the primary caregivers of children and therefore the persons entitled to receive the tax credit. The importance of the CCTB for women is evidenced by the fact that more women than men head lone parent families and the number of lone parent families is increasing.[123] Aboriginal women and women of colour are more likely to be lone parents than white women[124] and single mothers with children are the poorest of the poor.[125] Women and children's poverty are inextricably linked. Any evaluation of the CCTB must take place in a manner that recognises the role of women as the primary caregivers of children and the link between women's poverty and their children's poverty.

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[121] The presumption that the female parent is the primary caregiver can be rebutted when it is clear that this is not the case and therefore the presumption will not apply in certain circumstances.

[122] See, for example, Frances Wooley, Arndt Vermaeten and Judith Madill, "Ending Universality: The Case of Child Benefits" (March 1996) *Canadian Public Policy* 24; Ken Battle, "National Child Benefit: Renewing the Federation Through Social Policy Reform" (January/February 1997) *Policy Options* 46; Ken Battle, *The National Child Benefit: Best Thing Since Medicare or New Poor Law?* (Ottawa: Caledon Institute of Public Policy, 1997); Jane Pulkingham and Gordon Ternowetsky, "The New Canada Child Tax Benefit: Discriminating Between the 'Deserving' and 'Undeserving' Among Poor Families with Children" in Jane Pulkingham and Gordon Ternowetsky eds., *Child and Family Policies* (Halifax: Fernwood Publishing, 1997) and Douglas Durst ed., *Canada's National Child Benefit, Phoenix or Fizzle?* (Halifax: Fernwood Publishing, 1999).

[123] Figures from the 1996 census show that lone parent families headed by women outnumber those headed by men by more than four to one. See Statistics Canada "1996 Census: Marital Status, Common-law Unions and Families" *The Daily* Catalogue 11-00IE (October 14, 1997) at 2.

One of the major weaknesses of the CCTB is its limited application. The CCTB, and in particular the National Child Benefit portion of the program, is targeted at the working poor. The 1997 changes did not address directly the needs of those women with children who receive social assistance. As Ken Battle has pointed out "the National Child Tax Benefit will not increase child benefits for welfare families and will augment child benefits only for low-income families not on welfare (i.e., working poor and low-income employment insurance families)".[126] Women's ability to participate fully in the paid labour force is adversely affected by their primary care-giving role for their children. The result is that there are many women who cannot "afford" to participate in the paid labour force. Women who cannot participate in the paid labour force receive less of a benefit than their counterparts who do participate in the paid labour force. Yet, in many instances it is women on social assistance who are most in need of financial assistance. Statistics show that women predominate those who receive social assistance.[127] There is another dimension to this issue. Women with disabilities are particularly disadvantaged by the linking of the CTTB to workforce participation. Statistics show that women with disabilities who have dependent children have a very low rate of participation in the paid labour force. In 1991, for example, only 48% of women with disabilities were in the paid labour force and women with disabilities with dependent children were less likely than non-disabled women with children to be employed.[128] The problem is that by tying the amount of the CCTB received to work status, the poverty of many women and their children is further entrenched.

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[124] Statistics Canada, *Lone-Parent Families in Canada*, Catalogue 89-522E, (December 1992), Table 1.9.

[125] Using statistics from 1996, Ken Battle has stated that "six in ten children (61.9 per cent) in single-parent families led by women lived on low incomes at last count compared with one in seven (13 per cent) children in two parent families", Battle, "The National Child Benefit" in Durst, *supra* note 122 at 39. In 1997 56 per cent of female headed lone parent families lived in poverty, Statistics Canada, *Income Distributions by Size in Canada, 1997* (Catalogue 13-207-XPB, July 1999) at 34-35 and Text Table IV. See also p. 187 and Table 67.

[126] Battle, *ibid.* at 48.

The reduction in the amount of the CCTB received for each child under 7 by 25 per cent of any child care expenses deducted under section 63 of the Act is an added burden for those women who need child care to participate in the paid labour force. Given the lack of affordable child care and the inadequate amount of the deduction under section 63, any extra cost, such as losing part of the child care expense deduction in order to claim the full amount of the CCTB, is unfair.

A key issue with respect to a refundable tax credit such as the CCTB is that its success as a social program depends on individuals claiming the tax credit. Because the program is delivered as a refundable tax credit, payment depends on an individual filing a tax return and claiming the credit. In the case of an individual with a spouse, the spouse must also file a return because the amount of the CTTB is based on a calculation that takes "family" income into account. Unfortunately many women are not claiming benefits to which they are entitled. In 1998, Revenue Canada confirmed that 5 per cent of women who had a baby in 1995 or 1996 did not claim the child tax benefit (the forerunner of the CTTB) and almost 10 per cent of potential child tax benefit claimants had their benefits interrupted or did not receive benefits to which they were entitled because they or their spouses did not file income tax returns on time.[129] These figures are unacceptable, given the importance of the CCTB to women and children. In addition, there is a class aspect to this problem. It is very likely that those who do not claim the CCTB are those women who need it most, that is low-income women. Because their income is so low these women do not pay tax and therefore are less likely to complete a tax return. There are also many women, especially those on social assistance, who do not have a fixed address at which to receive the payments and they too may not receive the amount to which they are entitled.

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[127] In 1997, for example, statistics showed that while 27 per cent of single mothers were on social assistance, only 3 per cent of single fathers received social assistance. See National Council of Welfare, *Profiles of Welfare: Myths and Realities* (Ottawa: Minister of Public Works and Government Services, 1998) at 8.

The fundamental issue when considering the effectiveness of the CCTB is whether the tax system is the appropriate tool by which to deliver the program. What makes this issue so pertinent is that it is only relatively recently that the tax system began to be used to deliver this subsidy. Up until 1992, the family allowance was a direct grant made to the mothers of all children under the age of 18. The tax system was not used to deliver the subsidy, although as discussed above, it was used to limit the amount of the

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[128] Gail Fawcett, *Living with Disability in Canada: An Economic Portrait* (Ottawa: Office for Disability Issues, Human Resources Canada, 1996) at 24 and 159-159.

[129] Minister of Revenue, *1996-97 Benefit Programs Report* (Ottawa: Revenue Canada, 1998) <http://www.rc.gc.ca/E/pub/tg/3940b1ed/README.html>.

subsidy. Has the integration of the family allowance into the tax system contributed to a better targeted subsidy and improved its delivery? I would suggest, given the problems outlined above, that the answer is no. Consideration should be given to removing the family allowance portion of the CCTB from the tax system and delivering it by way of a direct grant.

V. PROVISIONS THAT RECOGNIZE ECONOMIES OF SCALE IN SPOUSAL RELATIONSHIPS

Several tax measures can be said to take into account the economies of scale that are assumed to arise from spouses living together and sharing the cost of certain items such as rent, household expenses, including major purchases such as furniture and other associated costs. Economies of scale, the argument goes, increase a taxpayer's ability to pay. Therefore the spousal unit (which benefits from these economies of scale because the spouses live together) should pay more tax than two separate individuals with the same total income. Some of the tax rules that take the savings associated with economies of scale into account include, for example, rules that require certain tax deductions to be taken by the spouse with the lower income such as the child care expense deduction. This rule frequently means that more taxes are paid, or to put it another way, less of a tax subsidy is received, than would be if the rule did not apply. The reason for the reduced tax subsidy is that the person required to take the deduction pays tax at a lower marginal rate than their spouse by reason of that person's lower income.

Another set of rules that are designed to take economies of scale generated by persons living together into account are those rules that reduce entitlement to a tax credit as income increases and, when income reaches a certain level, eliminate entitlement to the credit. The GST tax credit and the Canada Child Tax Benefit both include income tests of this nature. In each case it is the income of the spouses that is aggregated, meaning that entitlement to the credit is reduced more quickly for the spousal unit than it would be if each spouse were treated as a separate individual for the purposes of calculation of the credit.

There are several problems with taking economies of scale into account in determining the amount of and entitlement to tax subsidies. Even the strongest proponents of joint taxation of spouses do not rely on the benefits from economies of scale to support their position.[130] One reason is that the role of the tax system is not to redistribute benefits based on economies of scale. As discussed in Chapter One, the tax system is intended to redistribute income, and to a lesser extent wealth, but it does not include any benefits gained from economies of scale in a taxpayer's income. For example, the benefits gained by purchasing items in bulk (an economy of scale) rather than singly are not taxed. There is another aspect to this issue. While there may be a benefit from the economies of scale enjoyed by spouses living together in terms of shared expenditures, there is also a cost. The items purchased and which give rise to the economies of scale must be shared between the spouses.[131]

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[130] Michael McIntryre, a noted U.S. tax academic, is one of the strongest proponents of the joint taxation of spouses. Despite this position, he agrees that economies of scale that arise from living together are irrelevant in assessing tax liability. See Michael McIntyre, "Implications of Family Sharing for the Design of an Ideal Personal Tax System" in Richard Bird and Sijbren Cnossen eds., *The Personal Income Tax: Phoenix from the Ashes* (Amsterdam: North Holland, 1990) at 197-198.

Perhaps the strongest argument against taking economies of scale into account when considering how spouses should be taxed is that there are economies of scale to be enjoyed in many other relationships. For example, two students who share an apartment save expenses through their shared accommodation and lifestyle together but the tax system does not treat them in the same manner as spouses for the purposes of provisions that aggregate income, such as the GST tax credit and the Canada Child Tax Benefit. I now turn to a discussion of three provisions based on economies of scale, the child care expense deduction, the GST tax credit and the Canada Child Tax Benefit.

A. The child-care expense deduction

Section 63 of the Act permits a deduction in the computation of income for child-care expenses paid with respect to an eligible child. Allowable child care expenses include amounts paid for babysitting services, day nursery services and boarding school and camp fees, although there are weekly maximum amounts prescribed for the latter two expenses. The child care expense must have been incurred to enable the taxpayer or supporting person who resided with the child to perform the duties of employment, carry on a business, carry on grant-funded research or attend a designated educational institution or secondary school, subject to certain conditions.[132]

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[131] Brooks, *supra* note 82 at 49.

[132] Full time students are eligible to claim the child care expense deduction and the 1998 budget proposed that part time students also be eligible for the deduction. It should be noted that

Section 63 defines an eligible child as a child of the taxpayer or taxpayer's spouse, or a child dependent on the taxpayer or the taxpayer's spouse and whose income does not exceed $7,044 for the 1999 taxation year.[133] In addition the child must be under 16 or a child in respect of whom the disability tax credit is claimed. For the 1999 and subsequent taxation years the amount of the child care expense deduction is $7000 for each child under seven or a child in respect of whom the disability tax credit is claimed, and $4000 for each child aged seven to fifteen or a child who is not eligible for the $7000 deduction but who has a mental or physical infirmity.[134] The deductible amount is limited to the lesser of the amounts described and two-thirds of the taxpayer's earned income for the year. In two parent families the deduction must be claimed by the person earning the lower income, except where he or she is a full-time student, in prison, incapable of caring for the children, or living apart from the other person for at least ninety days by reason of the breakdown of their relationship. A recent change to the rules introduced in the 1996 budget means that single parents or couples studying full time (including at high school) are now permitted to deduct child-care expenses against all types of income. This change is to be welcomed as it allows women who may be retraining to return to work to take advantage of the deduction.

There is no question that the amount of the deduction is inadequate and that the problems presented by the monetary limitations on the amount that may be deducted

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none of the changes proposed in the 1998 budget have yet been enacted, although legislation implementing them is expected to be passed soon.

[133] This amount is the total of the basic personal amount ($6,456) under section 118(1) and the supplementary credit ($500) under section 118(1)B(b.1). The supplementary credit was proposed by the 1998 budget.

[134] These amounts were introduced in the 1998 budget but have not yet been enacted. Prior to the 1998 change the amounts were $5000 and $3000 respectively.

are further exacerbated by the rule requiring the spouse with the lower income to take the deduction in most cases. As mentioned earlier, this problem arises because the rule requires that the deduction be applied to reduce income that may be taxed at a lower rate, thereby resulting in less taxes saved than would have been the case if the deduction were taken by the high rate taxpayer. The maximum amount deductible under section 63 is only $7000 a year for a child under 7. This translates to a subsidy of only $3,500 a year for an individual who pays tax at a high rate of 50 per cent. If, however, that individual has a spouse who pays tax at a lower rate such as 20 per cent, the couple will only receive a subsidy of $1,400, thus losing entitlement to the $2,100 subsidy to which they would have been entitled, but for the rule requiring the deduction to be taken by the spouse with the lower income. Given the high cost of child-care in Canada, any rule that limits the amount of the subsidy is inappropriate. As well, the limitation on who may claim the deduction has an arbitrary impact that is dependent on the marginal tax rates of the spouses, not on their child-care needs. The cost of child-care varies from province to province and is also affected by the nature of the care, that is whether it is provided in the home or in a child-care facility. In 1988 the Canadian National Child Care Study estimated the cost of regulated child-care at $7,188 a year for infants and $5,361 for pre-schoolers.[135] Since that time the costs have risen considerably with estimates running at a high of $9,396 for infants and almost $6,000 for pre-schoolers.[136]

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[135] Alan Pence, ed., *Canadian National Child Care Study: Child Care in Context: Perspectives from the Provinces and Territories* (Ottawa: Statistics Canada, 1992) at 396.

[136] See Child Care Canada, *Fact Sheet 3*, at <http://www.childcarecanada.org/resources/CRRUpubs/>.

The inadequacy of the amount of the section 63 deduction is exacerbated by the fact that section 63 provides a deduction from income, which ties the value of the deduction to the taxpayer's tax rate. This means that an individual paying tax at a high rate receives a larger tax subsidy than an individual paying at a lower rate. Such a system establishes a hierarchy of taxpayers that is in inverse relation to their ability to pay for child-care. At the top are those with the highest incomes. Below them, in declining order, are taxpayers with lower incomes. At the bottom are taxpayers to whom the deduction is worthless because they have little or no income to which to apply the deduction. This problem is exacerbated by the fact that those with higher incomes tend to claim a greater amount as the child-care expense deduction than those with lower incomes.

In addition to the concern about the benefits from the economies of scale, other reasons for requiring the deduction to be taken by the lower income earning spouse include reducing the cost of the tax expenditure and ensuring that the subsidy is delivered to women, who tend to be the lower income earners in spousal relationships. This targeting of women is, in turn, designed to remove some of the barriers to women's participation in the paid labour force by delivering a subsidy to defray some of the costs of child-care. But the problem is that the current rule requiring the spouse with the lower income to take the deduction is contradictory in effect. While it does deliver the subsidy to many more women than men, it also reduces significantly the amount of the subsidy that women receive.

Various suggestions for improvement to the child-care expense deduction have been made, including converting the deduction into a tax credit. Such a measure would mean that the income level of the recipient would be irrelevant in determining the amount of the subsidy because a tax credit is worth the same in terms of tax dollars saved to all taxpayers regardless of the rate at which they pay tax. Furthermore the credit could be made refundable, meaning that women who do not have taxable income could also receive a subsidy. Converting the deduction to a refundable tax credit is not a novel suggestion and has been suggested by many groups, including the National Council of Welfare,[137] the National Association of Women and the Law (NAWL)[138] and the Ontario Fair Tax Commission, Women and Taxation Working Group.[139] Such a refundable tax credit could be modeled on the GST tax credit and provided by way of a quarterly payment. Providing the benefit up front and on a regular basis instead of delaying "payment" until a tax return is filed would recognize the recurring nature of child-care costs.

It is important to note that Quebec has taken a very different approach to the issue of funding child-care. In 1997 the Quebec government created the Ministry of Family and Children (le Ministère de la Famille et de l'Enfance) and introduced a new "family" policy. Part of that policy included the establishment of optional full-time kindergarten for all 5 year old children. Concurrently, in September 1997 Early Childhood Centres were created to provide children under 5 years old with early childhood education and child-care services. Since that time the Quebec government has moved forward with its $5 a day child-care program. Under this program, which is to be extended to all children under 5 by the year 2000, parents pay $5 a child for child-care at an Early Childhood Centre. Those parents who do not have access to those centres receive the Quebec refundable child care tax credit under the Quebec Taxation Act.[140] From 1998 onwards the tax credit is based on the excess net family income over a threshold of $26,000.[141] The main difference, however between the federal child-care expense deduction and the Quebec tax measure is that the latter is a refundable tax credit not a deduction in the computation of income. Thus Quebec has embarked on a policy that is moving away from using tax subsidies to fund child-care to a recognition that a better approach is to fund child-care directly.[142]

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[137] National Council of Welfare, *Child Care: A Better Alternative* (Ottawa: Supply and Services, 1988) at 20.

[138] National Association of Women and the Law, *Background Paper in Support of Tax Resolutions* (Ottawa: National Association of Women and the Law, 1991) at 6.

[139] Ontario Fair Tax Commission, *supra* note 88 at 31.

The Quebec experience raises the issue of whether the tax system should be used to fund child-care or whether the government should move towards a system that provides state funded child-care centres for young children. That is an issue for further debate. At present the major source of federal funding for child-care is provided by the tax system and therefore it makes sense to ensure that the current rules operate fairly. The requirement that the spouse with the lower income take the deduction for child-care expenses imposes a hardship on many couples because the amount received is often less than that amount that would be received if spousal status were not taken into account. For the reasons outlined above, justifying this limitation on the basis that the couple enjoys economies of scale with respect to their purchases is not a persuasive argument. As long as the tax system is used to deliver this subsidy, thought should be given to making the child-care expense deduction fairer by ensuring that its value is not tied to the taxpayer's marginal tax rate. The obvious way to make the deduction fairer is to convert it to a refundable tax credit and not take family income into account. Such a measure would redress the current inequality experienced by those in spousal relationships when compared to single persons. It would ensure that both a taxpayer's spousal status and their marginal tax rate would be irrelevant in determining the amount of the subsidy that they receive for their child-care expenses.

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[140] *Taxation Act*, R.S.Q., c.I-3, sections 1029.8.67 to 1029.8.82 and 1086.5 to 1086.8.

[141] *Taxation Act*, R.S.Q., c. I-3, sections 1029.8.67 to 1029.8.82 and 1086.5 to 1086.8.

[142] For an excellent analysis of the Quebec approach to funding child care see, Jocylene Tougas, A *Snapshot of Quebec's Current Early Childhood Education and Child Care Reform*, <http:/www.childcarepolicy.org/tougas/-htm>.

B. The Goods and Services tax credit and the Canada Child Tax Benefit

The GST tax credit and the Canada Child Tax Benefit both take aggregated "family" income into account in determining entitlement to the respective tax credits. The result of this aggregation is that the amount received by the spouses is often less than the amount that they would receive if their spousal status were not taken into account. A related point is that because entitlement to the subsidy diminishes as income increases, the aggregation of the spouses' income means that they will lose access to the subsidy more quickly than two individuals with the same total amount of income. The rules in respect of the CCTB have been discussed in detail earlier in this Chapter. The GST tax credit provides a benefit of up to $199 for each adult and an additional supplement of $105 for single adults. The credit is reduced by 5 per cent of family net income in excess of $25,921. Family net income is the income of the individual and their spouse.[143] The following point illustrates how effective these two provisions are in terms of restricting both access to these tax subsidies and the amount received. The recent change to the definition of spouse to include lesbians and gay men will result in a significant tax windfall for the government, rather than a tax cost. The reason is that the aggregation of "family" income will reduce access to these subsidies for many couples who will now be considered to be spouses under the Act, thereby producing increased tax revenues for the government. The amount of the increase in tax revenues will be significantly greater than any tax costs arising from the impact of those provisions that provide a tax saving to spouses.[144]

The rationale underlying the income testing by reference to family income of these two tax subsidies is that subsidies delivered by way of a direct grant, such as, for example, social assistance payments are also income tested. Such a comparison has led one commentator to argue that the provisions should remain as they are. She argues that

> Family income is used to prevent tax leakage by ensuring that only one of two people with low incomes can claim the benefits. Not to do so would be enormously expensive and, in the current economic and political climate, not feasible without drastic cuts being made to the size of programs or the amount of the benefits.[145]

Neil Brooks has argued that there is no inconsistency in having the individual as the tax unit but basing transfer payments such as the GST tax credit and the CCTB or those payments delivered by way of direct grants on the aggregated income of spouses.[146] As he notes "[t]ransfer payments in order to relieve poverty should quite sensibly be based on some function of consumption instead of control of income."[147] There is another

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[143] Section 122.5(1) of the Act.

[144] On this issue see, Albert Wakkary, "Assessing the Impact of Changing Marital Rights and Obligations: Practical Obligations", (2000) 17 *Canadian Journal of Family Law* 201 at 209.

[145] Maloney, *supra* note 103 at 147.

[146] Brooks, *supra* note 82 at 78.

[147] *Ibid.*

dimension to these two tax credits. Not only do they assume that there are economies of scale to be gained from living in spousal relationships, they also assume that income and wealth are pooled in these relationships, and especially where the income of the spouses is relatively low. This issue is discussed in detail in the next part of this Chapter that examines provisions based on an assumption of economic mutuality. As discussed in that part, that assumption is problematic for several reasons. The issue is a complex one and this is reflected in the report of the Ontario Fair Tax Commission, Women and Taxation Working Group. That group was divided on whether income aggregation should remain part of these tax credits. Some members believed that the individual should be the unit of taxation for tax delivered assistance in order to protect the autonomy of women while other members took the view that such a position might undermine the integrity of these programs and give rise to unacceptable cost implications.[148] I suggest that as long as income aggregation remains part of the social assistance system, then it should remain a part of the two tax subsidies that are of a similar nature. To remove the aggregation of income inherent in the GST tax credit and the CCTB would fly in the face of the intent of the provisions which is to provide subsidies to those with low incomes.

VI. PROVISIONS THAT ARE BASED ON AN ASSUMPTION OF ECONOMIC MUTUALITY

A. Introduction

As Appendix A demonstrates the majority of the provisions that recognize spousal relationships are based on an assumption of economic mutuality. Some of these rules benefit taxpayers by, for example, permitting the deferral to a future time of taxes that would otherwise be payable. Other rules disadvantage taxpayers by either reducing the amount of a tax subsidy or increasing the amount of taxes payable. The discussion of the rules proceeds as follows. First, I shall analyze the assumption underlying these provisions which is that spouses tend to share or pool their income and wealth. Then I shall turn to a description and analysis of some of the more important rules based on an assumption of economic mutuality within spousal relationships that benefit those in spousal (and familial) relationships in comparison to individual taxpayers. Only after a detailed description of the policy underlying the rules and their operation, can any suggestions be made with respect to the future of these rules. A similar analysis is applied to those rules based on economic mutuality which operate to disadvantage those in spousal (and familial) relationships in comparison to individual taxpayers.

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[148] See, Ontario Fair Tax Commission, Women and Tax Working Group, *supra* note 88 at 16.

B. Is there a sharing and pooling of income and wealth in spousal relationships?

The answer to this question is difficult to determine. As has been noted by many who have written about this issue, there is a dearth of empirical data about sharing and pooling of income and wealth.[149] Therefore much of the information is extrapolated from data not directly on point, but from which one can draw some conclusions about the issue. The position one takes on this issue is influenced by whether one subscribes to the control theory of taxation or the benefit theory.[150] If you believe that taxpayers should be taxed on income from which they benefit, then you would argue that a key concern is how those in spousal relationships spend their income and who benefits from that spending. You would assume that if spouses are sharing expenses they are also pooling their income and, therefore, argue that they should be treated differently than two individuals. If you subscribe to the control theory and believe that individuals should be taxed on the income that they control, then how couples spend their money is not as relevant to your analysis. Rather, the key issue is who controls the savings and accumulated capital of the couple. If there is true equal control of these amounts, only then can an argument be made to treat spouses differently from individuals. It is clear that, with the exception of Michael McIntyre,[151] most of those writing on this issue subscribe to the control theory. Consequently, the issue can be framed as one that is about shared wealth and pooled income rather than shared expenses.

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[149] See, for example, Brooks *supra* note 82 at 62-63, Maloney *supra* note 103 at 128, Ontario Fair Tax Commission, Women and Tax Working Group, *supra* note 88 at 7, Michael McIntyre, "Marital Income Splitting in the Modern World: Lessons for Australia from the American Experience" in Richard Krever and John Head eds. *Tax Units and the Tax Rate Scale* (Melbourne: Australian Tax Research Foundation, 1996) 1 at 3, Louise Dulude, "Taxation of the Spouses: A Comparison of Canadian, American, British, French and Swedish Law" (1985) 23 *Osgoode Hall Law Journal* 67 at 89, Kornhauser, *supra* note 104 and Frances Wooley, *Women and Taxation: A Survey* (Research Paper prepared for the Women and Taxation Working Group of the Ontario Fair Tax Commission, 1991).

Most commentators believe that there is not much sharing or pooling in spousal relationships of retained income or assets. As Neil Brooks states "there is not anywhere near full sharing in many households, let alone sharing of control that would indicate both spouses value family assets".[152] The Women and Taxation Working Group of the Ontario Fair Tax Commission agrees and makes the point that it is men who tend to control income and capital,[153] a point that is reiterated by the Fair Tax Commission in its final report.[154] Louise Dulude has a more nuanced analysis that takes class into account. She concludes that couples with relatively low and equal incomes tend to share more than other couples. She states that "with the single exception of the very poor, the earnings and assets of couples are generally controlled and managed by the spouse who has legal title to them".[155] Given that men are wealthier and own more capital than women,[156] we can conclude that the control generally remains with them.

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[150] See the discussion of this issue in Chapter Two.

[151] McIntyre, *supra* note 149.

[152] Brooks, *supra* note 82 at 63.

[153] Ontario Fair Tax Commission, Women and Taxation Working Group, *supra* note 88 at 7.

There are other situations where one can speculate that income and capital is not shared or pooled in a relationship. For example, relationships in which there is violence are not likely to be ones in which there is sharing and pooling of income and wealth. Finally, intuition suggests that true sharing of income and assets is most likely to take place when the incomes of the spouses are relatively equal. But the tax rules that are based on an assumption of spousal sharing are not designed to target those couples in particular. Indeed, many of the rules that give a tax advantage to spouses on the basis that there is an economic mutuality are designed to redistribute wealth within the relationship. Rules such as the rollover provisions that permit the transfer of capital property between spouses on a tax-free basis with a deferral of tax until the property is ultimately disposed of assume a certain inequality with respect to the distribution of wealth and income in the relationship. Their intent is to facilitate the amelioration of that inequality by permitting capital property to be transferred within the relationship without any tax consequences.

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[154] Ontario Fair Tax Commission, *supra* note 88 at 262.

[155] Dulude, *supra* note 149 at 89.

[156] On this issue see, Lisa Philipps, "Tax Policy and the Gendered Distribution of Wealth" in Isabella Bakker ed., *Rethinking Restructuring: Gender and Change in Canada* (Toronto: University of Toronto Press, 1996) 141 at 142-150.

Opinion among tax policy analysts is divided on whether provisions based on economic mutuality should be repealed. The most vigorous proponent of repeal is Maureen Maloney. In a book chapter prepared for the Ontario Fair Tax Commission, she argued that these provisions be repealed because they

> provide preferential treatment on the basis of joint living. Joint living already results in considerable economic and imputed savings, so it is difficult to see why the income tax system should compound the tax advantages.[157]

It is important to note, however, that Maloney's list of provisions that are based on economic mutuality was brief and only included those provisions that gave a tax advantage to the spouses. Her recommendation was not adopted by the Fair Tax Commission, which was agnostic on the issue. Meanwhile Neil Brooks' conclusion was that most of these provisions do "justifiably recognize some commingling of affairs between spouses, some pooling of economic resources, and some joint decision-making."[158]

I contend that given the numerous rules that are based on an economic mutuality between spouses the best approach is to do a rule-by-rule analysis of the most important rules. Such an approach allows for a more in-depth consideration of the provisions that can also take into account any subsidiary policies underlying the particular rules. I also suggest that whether the rule operates to the advantage or to the disadvantage of the spouses is a relevant factor in determining whether the rule should be retained. Many of the rules that are to the advantage of the spouses are designed to redistribute wealth and income in the relationship and, given women's lack of access to wealth, that is a laudable policy.

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[157] Maloney, *supra* note 103 at 147.

[158] Brooks, *supra* note 74 at 36. It should be noted that Brooks did not embark on an analysis of all these rules, but rather focussed on a few of the more significant ones.

C. Provisions based on economic mutuality between spouses and that are of advantage to the taxpayer

Space does not permit an in-depth analysis of all the provisions listed in Appendix A that are based on economic mutuality between spouses and that are of advantage to the taxpayer. Therefore, the focus in this part is on those provisions that have been the subject of most comment. They include the rollover provisions that allow the transfer of capital property, including the family farm, on a tax-free basis to a spouse or child. Some of these provisions operate on an *inter vivos* basis and others on death of the taxpayer. Other provisions considered are the rules that apply to retirement savings and pensions, including the rules that relate to spousal registered retirement savings plans and spousal survivor benefits under a registered pension plan.

1. Transfer on a tax-free basis of capital property on an *inter vivos* basis to a spouse, a former spouse or a spouse trust

The Act contains numerous provisions that permit the "rollover" of capital property to a spouse, a former spouse in settlement of rights arising from the marriage or a spouse trust. Generally, when a person disposes of capital property and the property has appreciated in value and thereby generated a capital gain, three-quarters of that gain is included in income.[159] Conversely, if the property has lost value the taxpayer may deduct three-quarters of that loss as an allowable capital loss in many circumstances. Section

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[159] The 2000 budget proposes that for gains realised after February 27, 2000 the portion of the gain that is required to be included in income decreases to two-thirds.

73(1) provides that in the case of an *inter vivos* transfer of capital property to a spouse, a former spouse in settlement of rights arising from the marriage or a spouse trust by an individual, the proceeds of disposition of the individual is the cost of the property to that individual.[160] The result is that the transfer takes place on a tax-free basis and the tax consequences of any gain or loss with respect to the property are deferred until the spouse, former spouse or spouse trust ultimately disposes of the property.

The policy underlying the *inter vivos* transfer of capital property to a spouse, former spouse or spouse trust is multi-faceted. First, these rules serve an administrative purpose. If transfers between spouses were taxable events, Revenue Canada would need to trace all such transactions in order to ensure that any tax owing was paid. Such a task would be almost impossible given the informal context in which these transactions take place. The rollover rules mean that no such tracing is necessary. Secondly, the rules encourage the redistribution of property within a spousal relationship, although it is important to note that if the capital property is income producing, then the transfer must be at fair market value in order to avoid the attribution rules. But to the extent that the property is non-income producing and has appreciated in value since it was acquired, the rollover removes any disincentive to the transfer that would otherwise arise by reason of the tax liability that would ensue as a result of the disposition. The rules that allow the transfer of capital property on a tax-free basis to a former spouse in settlement of rights arising out of their marriage are intended to facilitate the transfer of capital property on breakdown of spousal relationships.[161] Kathleen Lahey has commented on how this rule came into being in the 1970s in the wake of family law reform "to ensure that when husbands were... ordered to transfer family property on divorce, for example, those transfers did not trigger 'unintended' tax liability on the part of the husbands".[162] There is also a practical aspect to the rules that allow tax-free transfers of capital property within spousal relationships. Without these rules tax would be payable in those instances where the capital property had appreciated in value. The problem is that transactions between spouses do not take place in the open market and this fact presents a liquidity problem. There may be no funds with which to pay the taxes owing as a result of the disposition of the property.

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[160] Section 73(1) of the Act provides that in the case of non-depreciable property the proceeds of disposition are the cost of the property and in the case of depreciable property the proceeds of disposition are the undepreciated capital cost that can be attributed to the property.

The rollover to a spouse trust has been the subject of some criticism. Section 73(1) provides that capital property can be transferred on a tax-free basis by an individual to a trust of which the individual's spouse is the beneficiary, provided certain conditions are met. Those conditions include the requirement that no one other than the spouse may obtain any of the income or capital while the spouse is alive and that the spouse must be entitled to receive all of the income of the trust during her lifetime. The critique of this rule is that it allows the transferor to determine who the ultimate beneficiary of the property will be. Further, the spouse has no legal control over the property but rather only a beneficial interest by reason of being a beneficiary of the trust.[163]

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[161] It should be noted that the reference to "marriage" includes common-law relationships. Property division on breakdown of marriage is a matter of provincial jurisdiction. Provincial legislation only applies to property division on breakdown of marriage and not to property division on breakdown of a common-law relationship. Nevertheless, section 73(1) of the Act is relevant in those situations where there was a transfer of property on breakdown of a common-law relationship and the property division was either the result of a constructive trust or a contract between the common-law spouses.

[162] Kathleen Lahey, *The Political Economies of Sex and Canadian Income Tax Policy*, presentation to the Canadian Bar Association (Ontario), Lesbian and Gay Legal Issues Committee, 1998 (unpublished) at 15.

Can the rollover rules be justified? To date only one commentator has called for their repeal, and that call was subject to the caveat that if "there is real economic mutuality that could be shown to exist between the couple, these provisions might be appropriate."[164] My view is that the best argument for the retention of these rules is that they are intended to facilitate the redistribution of capital property and wealth within spousal relationships and, in particular, from men to women. There is, however, a serious issue about whether this redistribution of wealth is a matter for the private family or whether the state should do more than merely facilitate intra-family transfers. Speaking of the rollover rule Lisa Philipps has commented that:

> It assumes and accepts a relation of support and dependency between husbands and wives, of which property transfers are a part. This relation is treated as natural, in the sense that it precedes the state and should not be disrupted by it. At the same time as it offers immediate financial relief for some women, the spousal exemption [the rollover rule] declares the state's unwillingness to take responsibility for the distribution of resources within the private world of the heterosexual family. As in so many other areas of the law, it simply gives women the right to keep whatever they manage to obtain from men privately.[165]

If an argument is to be made for the repeal of the rollover rules, then that argument must be accompanied by a call for more state responsibility for the redistribution of wealth from men to women in Canada. While the tax rules are flawed for the reasons discussed above, they are currently one of very few measures that attempt to attain some redistribution of wealth between men and women. The key question is, how effective are the rules in accomplishing that end? Currently there is not enough data to allow us to answer that question. I submit that before consideration is given to a repeal of or amendment to these rules, empirical data be collected in order to determine whether these transfers of capital property by men to women are actually taking place. If not, more direct state intervention designed to encourage redistribution of wealth between men and women may be appropriate.

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[163] See Brooks, *supra* note 82 at 77.

[164] Maloney, *supra* note 103 at 147.

[165] Philipps, *supra* note 156 at 153.

2. Transfer on a tax-free basis of certain property on death of a taxpayer to a spouse or spouse trust

Section 70(6) provides for a tax-free transfer of capital property to a spouse or spouse trust on the death of a taxpayer in a similar manner to the *inter vivos* transfer discussed above. The rollover is automatic, unless the deceased taxpayer's legal representative elects out of the rollover, in which case there is a deemed disposition of the capital property at fair market value.[166] Section 70(5.2) provides for the potential rollover of resource properties and land inventories on death of a taxpayer to a spouse or spouse trust. In each case, absent the rollover there would be a deemed disposition of the property on the death of the taxpayer and any appreciation in value from the time the property was acquired by the taxpayer to the time of the taxpayer's death would be fully included in income.[167] It should be noted that section 70(5.2) operates in a different manner than the rollover for capital property because it allows the legal representative of the deceased taxpayer to elect that the proceeds of disposition of the property that is transferred to a spouse or spouse trust be any amount between the original cost of the property and its fair market value. This concession allows the legal representative to choose to have a full rollover of the property to the spouse or spouse trust or to realize all or part of the gain in the deceased's terminal year. Again, the choice of which course to take would depend on the tax position of the deceased and, to a limited extent, whether the spouse planned to retain the property for some time or dispose of it relatively soon after acquisition. What is interesting is that this election in made by the legal representative of the deceased taxpayer and the spouse's consent to the election is not required. Consequently, the spouse has no control over the tax consequences relating to the deemed disposition of the resource property or land inventory on death of the taxpayer, consequences that affect her directly in terms of her own future tax liability. I suggest that this election should be a joint election by the legal representative of the deceased taxpayer and the spouse.

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[166] Section 70(6.2) of the Act provides for an election that the 70(6) rollover not apply. This election would be made in circumstances where, for example, the taxpayer had unused net capital losses that could be used to offset any capital gain on the deemed disposition of the property at fair market value. The result would be no tax for the deceased in the terminal year in respect of the disposition and a step up in the cost base of the property for the spouse who would take it with a cost equal to fair market value (in the case of non-depreciable capital property).

[167] While only three-quarters (soon to be two-thirds) of any gain on capital property is included income, all the gain on resource properties and land inventories is included in income, unless the rollover is available.

The policy underlying the rules that provide for the potential transfer of certain properties on death of a taxpayer to a spouse or spouse trust on a tax-free basis has several objectives. First, the rules help to avoid the "bunching" of income in the deceased's terminal year. Without these rules the deemed disposition of various properties that occurs on death of a taxpayer might result in a greater income for the deceased in the terminal year. That increase in income could move the taxpayer into a higher tax bracket, thereby increasing the deceased's overall tax liability. The rules also recognize the economic mutuality that exists between spouses and affirm that if a taxpayer bequeathes property to a spouse on death, that property should pass to the spouse without any tax consequences. In reality, the spouse simply steps into the shoes of the deceased taxpayer and any tax that would otherwise be exigible on death of the taxpayer is deferred until the spouse disposes of the property. Most taxing jurisdictions have rules that exempt intra-spousal transactions on death from tax, whether that tax is income tax, estate tax or a succession duty.[168]

It is perhaps easier to make a persuasive argument for the rollover rules that defer the tax consequences with respect to a deemed disposition on death of a taxpayer than it is in respect of the rules that apply to an *inter vivos* transfer to a spouse. While, as discussed above, it is unclear whether the *inter vivos* rollover rules actually encourage the redistribution of wealth from men to women in the spousal relationship, we do know that the rollover on death is a significant incentive to taxpayers to bequeath capital property to their spouses. Unlike an *inter vivos* transfer which is at the discretion of the taxpayer, on death there is an automatic disposition of the property for tax purposes and the only issue is whether the taxpayer bequeathes the property to their spouse or to someone else. Given the significant tax incentives related to the deferral of tax it is highly likely that the property will be left to the spouse. At the same time, this "defence" of the rollover on death is subject to my earlier comments about the importance of the state taking a role in ensuring that wealth is redistributed from men to women generally, and not just between those men and women in spousal relationships.

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[168] Canada does not levy estate taxes or succession duties.

I suggest that given the political realities of the situation, it is extremely unlikely that the rollover rules that apply on death of a taxpayer will be repealed. Death taxes, such as estate taxes and succession duties, are the most unpopular form of taxation. This point has not been lost on the federal or provincial governments, each of whom has, over the years, vacated the field of death taxes. The deemed disposition of capital property on death, while not a death tax *per se*, does share many characteristics with death taxes, including the tax liability that arises as a result of the deemed disposition. The rollover rules are the only tax rules that allow a deferral of that tax liability on death and, for that reason alone, are likely here to stay.

3. Transfer on a tax-free basis of farming property to a child of the taxpayer

Traditionally, the tax system has given preferential tax treatment to those engaged in farming activities. For example, farmers are permitted to use cash basis accounting in the computation of their income or loss rather than inventory accounting. The impact of this concession is that expenses associated with earning income may be deducted when they are paid. If farmers were required to inventory account, they would be required to match expenses to the goods sold, thereby having to defer the deduction of those expenses in many instances until a future year. The rules that permit the transfer of the family farm by parents to their children on a tax-free basis are in keeping with the concept of providing incentives for those engaged in farming. The idea that the family farm should be able to be passed on from generation to generation without tax liability as a result of the transfer has been an integral part of Canadian tax policy since capital gains became subject to tax in 1972.

Section 70(9) of the Act permits the transfer on death of a taxpayer of land or depreciable property used principally in the business of farming by the taxpayer (or the taxpayer's spouse or children) on a regular and continuous basis to a child of the taxpayer on a tax-free basis. For the purposes of this section, the definition of child of a taxpayer includes a child, a grandchild and a great-grandchild, thus extending the ambit of the tax advantage to transfers to a broad range of individuals related to the taxpayer. Furthermore, a child can be a child of any age. Section 70(9) allows the legal representative of the deceased taxpayer to elect that the proceeds of disposition of the property be any amount between cost and fair market value. This election means that if the deceased taxpayer has losses or any capital gains exemption available to apply to any gain, the legal representative can use up those losses or capital gains exemption and the child will take the property with a higher cost. The higher cost for the child is advantageous because it means that on any subsequent disposition of the property by the child the taxable gain will be less than it would otherwise have been without the step-up in the cost of the property. Section 70(9.2) permits a similar rollover to a child (or grandchild or great-grandchild) if the family farm is incorporated or operated as a partnership. Farming property can also "rollout" of a spouse trust to a child of the trust's settlor, with the result that if the taxpayer leaves the farm in trust for their spouse, on death of the spouse the property can be transferred on a tax-free basis to the taxpayer's child.[169] In addition, section 73(3) and (4) provides a rollover of farm property to a child of the taxpayer on an *inter vivos* basis.

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[169] Section 70(9.1) and (9.3) of the Act.

Obviously, the purpose of these tax provisions is to permit the family farm to be passed from generation to generation without the transferor being taxed on any gain that has accrued to the property.[170] Without these rules any gain that arose on the transfer of the farm property to a child (or spouse) would be taxed. I believe that these rules should remain in the Act. To date, there has been no call in any of the tax literature for their repeal. The rules can be justified on many bases, including their role in preserving the "family" farm. In addition, because the transfer of the family farm to a child is often a non-cash transaction, the tax liability that would arise in the absence of the rollover might have to be satisfied by a sale of some of the farm property to a third party or a loan secured by the farm property. Given the precarious state of the farming in Canada today, it would also be politically unfeasible to remove these rules. A related issue is whether the tax system is the best way to deliver this subsidy in respect of the family farm or whether a direct grant is more appropriate. Given that the tax relief in this situation is forgiveness of a potential tax liability, this expenditure is clearly best delivered by the tax system. The deferral of the gain until the farming property is transferred to someone other than a spouse or child is a neat and simple way to provide some monetary relief in respect of the family farm. Establishing a system of direct grants in lieu of the tax expenditure would only complicate the issue.

4. Tax provisions in respect of retirement savings and pensions

The rules that are discussed in this part relate to a variety of retirement and other deferred income plans. There are three types of rules. First, there are those rules that provide for a rollover on death of a taxpayer to the taxpayer's spouse of contributions made by the taxpayer to a deferred income plan such as Deferred Profit Sharing Plans(DPSP), Registered Pension Plans (RPP) or Registered Retirement Savings Plans (RRSP). Other rules in the Act allow the spouse to "step into the shoes" of the taxpayer on death of the taxpayer and receive survivor benefits under the taxpayer's RPP. Finally, there are those rules that permit contributions to be made by a taxpayer to a RRSP in their spouse's name.

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[170] While the provisions discussed above only apply to a transfer to a child of the taxpayer, section 70(6) and 73(1) of the Act would apply to provide a tax-free transfer of farm property that is capital property to a spouse either on death of the taxpayer or on an *inter vivos* basis.

There are several rules that permit contributions to various deferred income plans to be transferred on death of the contributor to a plan in their spouse's name without tax consequences. Thus, for example, while any withdrawal from a DPSP of unmatured contributions would be taxed on withdrawal, there is no tax if the contributor has died and the contributions are transferred directly to a DPSP, a RPP or a RRSP in the name of the contributor's spouse.[171] Similarly, if a taxpayer dies and has unmatured contributions in a RRSP, those contributions can be transferred to a spouse on a tax-free basis provided the spouse contributes them (or an equivalent amount) to their own RRSP.[172] Other rules provide for spousal benefits to be paid from a taxpayer's retirement savings plan. Regulation 8501 provides that RPPs may provide survivor benefits (either pre- or post-retirement) which ensure that pension payments made to an individual can, on death of the individual, be received by the individual's spouse. Finally a taxpayer may, subject to limitations as to amount, contribute to a RRSP in their spouse's name. The contribution may not exceed the taxpayer's own contribution limit, less any amount contributed to their own plan. The advantage of contributing to a spousal plan (rather than one's own plan) is that one is providing future retirement income for one's spouse and one is also splitting income with the spouse. In other words, income that would have accrued to the taxpayer and have been taxed in their hands on realization will be taxed in the hands of the spouse, who may well pay tax at a lower rate than the taxpayer because they have less income.

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[171] Section 147(19) of the Act.

[172] Section 146(8.1) of the Act.

The general policy underlying the three types of rules discussed above is to permit taxpayers to provide for retirement income for their spouses (primarily women) who are unable to contribute to a RPP or a RRSP on their own behalf. Many women are excluded from access to RPPs for a variety of reasons. One major reason relates to women's participation, or lack thereof, in the paid labour force. Even though more women than ever are working outside the home, the employment rate for women aged 25-54 was only 72 per cent in 1998.[173] For aboriginal women or women with disabilities, the figures are significantly lower. The labour force participation rate for aboriginal women is 49.7% and DAWN Canada (Disabled Women's Network) estimates that 65% of women with disabilities who wish to work are unemployed.[174] Women who are not in the paid labour force have no access on their own account to an RPP.

It is not only women's lack of participation in the paid labour force that limits their ability to benefit from tax subsidies for RPPs, but the kind of work that women do is also a major factor. Only those who work for relatively large employers who are economically able to provide a pension plan will benefit; those who work part-time, in non-unionized jobs, or for small employers unable to finance these plans, or those who are self-employed or unemployed, do not benefit. Women are disproportionately represented in the group unable to take advantage of the tax benefits. For example, between 1976 and 1991 women consistently represented at least 70% of part time workers.[175] In 1994 women held 69 per cent of all part time jobs and 26 per cent of employed women worked part time.[176] While some women cite personal and family responsibilities as the reason for working part time[177], over one-third of women working part time are seeking full time work.[178] Furthermore, more women than men work in non-unionized jobs,[179] and women generally work in sectors where pension coverage is the lowest, such as retail trade, and community, business and personal services.[180]

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[173] See Statistics Canada, *Labour Force Update: An Overview of the 1998 Labour Market*, Catalogue 71-005-XPB (Winter 1999) at 17, Chart 5.

[174] See Canadian Advisory Council on the Status of Women, *Work in Progress: Tracking Women's Equality in Canada*, (Ottawa: Canadian Advisory Council on the Status of Women,

Women who do not have access to work related pension plans may contribute to RRSPs, but the ability to take advantage of the preferential tax treatment afforded to contributions to these plans is dependent on having the funds with which to make the contribution. Given that women earn considerably less than men, they tend to have less

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1996) at 90 and Canadian Labour Congress, *Women's Work: A Report*, (Toronto: Canadian Labour Congress, 1997) at 5.

[175] Statistics Canada, *Women in Canada: A Statistical Report*, 3rd.ed. (Ottawa: Minister of Industry, 1995) at 73.

[176] Statistics Canada, *The Daily* <http://www.StatCan.ca/Daily/English/980317/d980317.htm> at 9.

[177] Statistics Canada, *supra* note 175 at 74.

[178] Canadian Labour Congress, *supra* note 174 at 25.

[179] *Ibid.* at 22.

[180] Caledon Institute of Social Policy, *Round Table on Canada Pension Plan Reform: Gender Implications* (Ottawa: The Caledon Institute of Social Policy, 1996) at 22.

discretionary income to contribute to a RRSP. This is evident when one looks at the statistics on who contributes to a RRSP and how much they contribute. In 1996 more men than women contributed to a RRSP, and although the disparity in the relative numbers of men (3,344,310) and women (2,655,690) who contributed was not particularly great, there was a significant difference in the amounts contributed. In total men contributed over $15 billion that year while women contributed just over half that amount, at $8.5 billion.[181] Therefore an argument can be made that spousal RRSPs are a partial solution to this problem of women's lack of access to these plans in their own right. But as Maureen Maloney has noted, the spousal RRSP is problematic for several reasons. As she says:

> In reality, the greatest benefit accrues to the high-income earner (the husband), who receives considerable tax savings; this benefit increases with his income since the tax benefit is given as a deduction rather than a credit. Moreover, ... It is unlikely that many wives will obtain decision-making power over assets transferred to them legally, and I suspect this is especially true when the transfers are made as a tax-planning device.[182]

While, at first glance the policy of providing for RPP spousal survivor benefits and spousal RRSPs may appear to be laudable, on closer examination the difficulties become apparent. These problems led the Canadian Advisory Council on the Status of Women to lobby in the 1980s for an end to this system and for pensions for women in their own right.[183] One major problem is that state subsidized benefits are being provided to individuals solely on the basis that they are in a particular defined relationship with another person. Single persons and those persons whose relationships have not, until very recently, been recognized by the tax system, such as lesbians and gay men, are and have been discriminated against over the years. As we know, the number of people living in families is declining and more women than ever are living alone or with their children.[184] Indeed a recent report shows a 19 per cent increase in the number of adults living without a partner between 1991 and 1996.[185]

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[181] Government of Canada, *Income Statistics, 1998* (Ottawa: Revenue Canada, 1998) at 103.

[182] Maloney, *supra* note 103 at 136-137.

[183] See Guest, *supra* note 114 at 197.

There is an argument to be made that all tax expenditures related to retirement saving be removed from the Act[186] and that the funds be used to enhance the more "universal" state pensions such as the Old Age Security (OAS) and Canada Pension Plan. The Canadian pension system is often described as a pyramid[187] with the OAS, a flat monthly amount paid to those over 65 at its base, supplemented by the Guaranteed Income Supplement. The next level is the Canada Pension Plan and the Quebec Pension Plan (CPP/QPP) both of which are intended to provide retirement income for those who have participated in the paid labour force. Because of the inadequacies of these government "public" pensions, recourse to "private" pensions such as RPPs and RRSPs is frequently necessary. It is clear that reliance on these private pension plans is a policy favoured and encouraged by recent federal governments. And yet, as discussed above, women have less access to these private pension plans. Consequently, some would argue that all tax preferences for retirement saving should be removed from the Act and that the public pensions be strengthened and improved. For example, some members of the Women and Tax Working Group of the Ontario Fair Tax Commission believed that "public subsidies for retirement savings (both RRSPs and pension plan savings) delivered through the tax system should be redirected toward expanding and enriching the public retirement security system (OAS, GIS and CPP/QPP).[188]

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[184] Ontario Fair Tax Commission, *supra* note 88 at 263.

[185] Statistics Canada, "1996 Census: Marital Status, Common-law Unions and Families", *The Daily* (October 14, 1997), <http://www.statcan.ca/Daily?English/971014/d971014.htm>.

[186] Retirement saving is heavily subsidised by the tax system. Contributions to RPPs by employers and employees deductible in the computation of income and income earned by the RPP accumulates on a tax-free basis. Similarly contributions to RRSPs are also deductible in the computation of income and income earned by the plan accumulates on a tax-free basis. In each case the value of the tax deduction and the deferral of tax on the income generated by the plans is considerable. For the 2000 tax year the value of all tax subsidies for RPPs is projected to be over $13 billion and the value of the tax subsidies for RRSPs is projected to be over $12 billion. See Finance Canada, *Tax Expenditures, 1999*, <http://www.fin.gc.ca/taxexp/taxexp99_2e.html>.

[187] Maureen Donnelly, "The Disparate Impact of Pension Reform on Women" (1993) 6 *Canadian Journal of Women and the Law* 419.

Unfortunately, political reality appears to dictate that in the current climate it is unlikely that more resources will be devoted to bolstering the OAS, GIS and CPP/QPP. Indeed given the federal government's proposed changes to the CPP the importance of this plan as a primary provider of income in retirement will diminish.[189] As Monica Townson says

> [B]enefits are being cut back and policies are now directed to reducing the role of government and increasing the role of the individual in providing for his or her own retirement. In light of this, it would appear futile to make proposals that would increase the benefits from government programs, even though it would be the best way to improve the financial future of women.[190]

If this is the case, the next question is whether there are improvements that could be made to the tax subsidies that might depart from the current policy of giving preferential tax treatment to those in spousal relationships. In Australia, the emphasis has been on getting more employers to provide pension plans for their employees. Thus the *Superannuation Guarantee Charge Act, 1992* requires employers to make contributions to a superannuation plan for each employee who earns more than $900 a month. Tax relief is given by way of a deduction to employers for their contributions, a low rate of tax (15 per cent) on earnings in the plan and a 15 per cent tax rebate (credit) for income received from the plan by superannuated employees. The result is that access to employment related pension plans is increased, thereby presumably reducing the need for special rules for spouses. But until measures to improve access to either the public or private pensions are introduced, the current rules in respect of spouses should be retained. Even though they are flawed and inadequate, they do help some women achieve income security in retirement.

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[188] Ontario Fair Tax Commission, Women and Tax Working Group, *supra* note 88 at 22. It should be noted, however, that the Working Group was divided on this issue with other members favouring changes to the tax rules that would improve their operation.

[189] For a discussion of this issue, see Guest, *supra* note 114 at 286.

D. Provisions based on economic mutuality that are disadvantageous to the taxpayer

1. Principal Residence

One of the most important tax subsidies in respect of home ownership is the principal residence exemption. Section 40(2) permits a home that qualifies as a principal residence to be designated as such and disposed of without any capital gain in respect of the residence being subject to tax. A principal residence qualifies for this exemption from tax if it is ordinarily inhabited for the period in question by the taxpayer, the taxpayer's spouse or former spouse or a child of the taxpayer.[191] Revenue Canada has taken a liberal interpretation about the meaning of "ordinarily inhabited", permitting, for example, summer cottages occupied for a short period of time by the taxpayer to

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[190] Monica Townson, *Women's Financial Futures: Mid-Life Prospects for a Secure Retirement* (Ottawa: Canadian Advisory Council for the Status of Women, April 1995) at 60.

[191] Section 54 of the *Act*, definition of principal residence.

qualify.[192] The result is that spouses owning more than one property may have two properties that each qualify as a principal residence. Up until 1982, both of these qualifying properties could be designated as principal residences. This concession allowed families that owned more than one property that qualified as principal residences to "double up" on the exemption and thereby avoid taxation of accrued capital gains on two homes. But the principal residence exemption consists of a two-part test. First, the property must qualify in the manner described above. Secondly, the property must be designated as a principal residence. The 1981 budget introduced a new rule with respect to the designation which provides that only one home may be designated as a principal residence in a given year by the taxpayer, the taxpayer's spouse and any unmarried children of the taxpayer under 18. Therefore the opportunity to designate two homes in a year by one family no longer exists. This change means that spouses are at a disadvantage in comparison to other non-spousal couples because the latter are able to claim two principal residence exemptions in a given year.

Given the tremendous tax savings that the principal residence exemption generates, the limit of one principal residence designation per family for each year is a sensible rule. For the 2000 taxation year, the value of the exemption is estimated to be over $1.2 billion. Moreover, if spouses were each allowed to use a principal residence exemption to avoid tax on capital gains, the benefit would accrue to those couples that could afford to own two properties. It is very likely that such couples would tend to be relatively wealthy and least in need of the tax subsidy. Furthermore, the principal residence exemption is not the only tax subsidy for home ownership. The non-taxation of imputed income from home ownership is a significant benefit to homeowners and disadvantages those who pay rent. The argument is that the "free rent" received by the homeowner is a form of earned income in kind and that it should be taxed.[193] Finally, while one can argue that provisions that are based on relationships of economic mutuality are problematic because they do not reflect the reality of relationships in which there may not be a sharing of wealth, this argument is not as persuasive with respect to the principal residence exemption. Generally the family home tends to be enjoyed equally by both spouses, and more importantly it tends to be jointly owned (and thereby controlled) by both spouses, meaning that this critique is less apt in this case.

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[192] Revenue Canada, *Interpretation Bulletin IT-120R4* (1993) at paragraph 12.

2. Provisions related to divorce and separation

Perhaps no other rules that apply to spouses have been so heavily criticized as the inclusion/deduction rules with respect to spousal support.[194] Section 60(b) provides a deduction in the computation of income for the payor of spousal support, provided certain conditions are met. Section 56(1)(b) requires that if spousal support is deductible by the payor, the recipient must include the amount in her income. These rules are highly gendered with the majority of those receiving spousal support, and therefore required to include the amount in income, being women. Meanwhile, it is men who are the primary beneficiaries of the tax deduction. The inclusion/deduction system for spousal support applies in respect of periodic payments paid for the maintenance of the spouse pursuant to a divorce decree or written separation agreement. The reason that these rules are included as provisions based on economic mutuality that disadvantage the spouses is because, while the overall intent of the rules is, as I shall discuss, to provide a tax subsidy to the spouses, the rules are highly flawed in this regard. The result is that while one spouse (usually the man) may benefit from the tax deduction, many women are experiencing a plunge into poverty as a result of divorce or separation and the adverse impact on them of the requirement to include spousal support in income. John Durnford and Stephen Toope cite several studies that demonstrate that while divorced men tend to experience an increase in income post-divorce, divorced women experience a significant decline in their income, a decline that often has the effect of taking them below the poverty line.[195]

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[193] It should be noted that, in this regard, the Carter Commission stated that "[a]n incentive of this magnitude leads to inequities between owners and renters. If it were administratively feasible, we would recommend that imputed net rental income be included in the tax base or, to compensate for not doing so, that the deduction of the rent paid by individuals who do not own their own home be permitted". See Government of Canada, *Report of the Royal Commission on Taxation*, Vol. 3 (Ottawa: Government of Canada, 1966) at 48.

[194] Much has been written on this issue. Perhaps the definitive article is John Durnford and Stephen Toope, "Spousal Support in Family Law and Alimony in the Law of Taxation" (1994) 42 Canadian Tax Journal 1. See also National Association of Women and the Law, *Background Paper in Support of Tax Resolutions* (Ottawa: NAWL, 1991); David Ross, "Income Tax Consequences of Property Transfers and Payments Made As a Result of Marriage Breakdown and Divorce", *Report of Proceedings of the Forty-First Tax Conference* (Toronto: Canadian Tax Foundation, 1990), and Maureen Maloney, *supra* note 83 at 22-24.

There are several rationales underlying the inclusion/deduction system. One justification is that the system delivers a subsidy to the recipient of spousal support in recognition of the extra costs associated with the move from one household to two on separation or divorce. The subsidy arises where the payor is in a higher tax bracket than the recipient because the monetary value of the deduction to the payor exceeds the amount of tax payable by the recipient. In theory, this permits a higher support award. It has been estimated that for 2000 the amount of the subsidy will be $250 million.[196] But there are many problems with this theory. In order that the recipient of spousal support not be at a disadvantage because of the tax liability, she must request an adjustment (the gross-up) to the amount of the spousal support to take her tax liability into account. If she is not successful in obtaining this increase, then she suffers the financial penalty of the lost tax dollars. Even if the amount is grossed-up to reflect the tax liability, the nature of the calculation makes it unlikely that she will be fully compensated. For example, in order to include the full tax liability of the recipient of spousal support, the amount of the award must be grossed up a second time so that the gross-up itself is then grossed up to take account of the tax liability. Without this further adjustment the tax payable on the gross-up is not taken into account, resulting in a failure to fully compensate the recipient for her increased tax liability. Also, because entitlement to credits such as the GST tax credit and the Canada Child Tax Benefit decreases as income increases, the inclusion in income of an award may have the adverse result of reducing the amount of those credits for the recipient of spousal support. It should also be noted that none of these adjustments to the amount of spousal support mean that the subsidy, if any, is in fact shared by the parties. The issue of grossing up and sharing the subsidy is not just a mechanical matter. In many cases, judges base the amount of the award on their perception of how much the payor can afford. In these cases women often receive less than required and at the same time bear the cost of the inclusion in their income of the amount. For those women who do not go to court but negotiate with their ex-spouses, the tax rules also present a problem. Negotiations about spousal support do not take place in isolation. Frequently they are part of ongoing negotiations about issues such as child custody and property division and this may result in trade-offs being made.

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[195] Durnford and Toope, *ibid.* at 10.

[196] Finance Canada, *supra* note 186.

Perhaps even more disturbing is that one cannot assume that the parties are in an equal position with respect to bargaining power.

Another justification given for the inclusion/deduction system is that giving a tax deduction to men means that they are more likely to pay spousal support. In other words, the system is an enforcement measure. Given that it has been estimated that "up to 85 per cent of all orders for the support of women and children remain unpaid or in arrears",[197] this justification is inadequate. There are many reasons that spousal support orders are in default, including hostility towards one's ex-spouse and the desire for revenge. It is too simplistic a view to believe that a tax deduction will result in better compliance with spousal support orders.

From a tax policy perspective the case for the inclusion/deduction system is very difficult to make. First, the income tax system operates on the basis of source income, which means that only income with a source, such as employment, business or property, is taxed. Windfall gains and other unearned amounts such as gifts or inheritances are not taxed. Spousal support does not have a source and indeed the only reason that it is included in income is because it is deductible to the payor. Secondly, as Neil Brooks notes "the design of the subsidy makes no sense: the size of the subsidy depends upon the differential in tax rates between the spouses and changes as the marginal tax rates of the spouses change".[198] Such a variation means that there is almost no control over how and to whom the subsidy is allocated. What is especially perplexing is why the tax system should be used to deliver a subsidy to two individuals who are no longer spouses and yet who, for the purposes of the Act, are treated as one tax unit. This confusion was at the core of the decision in *Thibaudeau* v. *Canada.*[199] In that case the Supreme Court of Canada refused to hold that the inclusion/deduction system with respect to child support payments discriminated against separated custodial parents in contravention of section 15(1) of the *Charter of Rights and Freedom.* The primary reason given by the majority of the court was that the relevant group for the purposes of their Charter analysis was separated or divorced couples or, as Cory and Iacobucci JJ. put it, the "post-divorce 'family unit'".[200] With this "unit" as the starting point for the section 15(1) analysis, it was easy for the majority to conclude that there was no discrimination because the inclusion/deduction system benefited the group of separated or divorced parents by generating "substantial savings".[201] Overall the tax burden of the couple was reduced even though the tax burden of the recipient of child support was increased.

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[197] Durnford and Toope, *supra* note 194 at 12.

[198] Brooks, *supra* note 82 at 75.

Basing tax policy on the premise that the divorced or separated couple is a single unit is problematic for several reasons. First, such a policy is at odds with one of the objectives of family law, which is to promote "clean break" or self-sufficiency of spouses after separation or divorce. While the *Moge* v. *Moge*[202] decision of the Supreme Court of Canada clarified that this objective was only one among others, including compensation for the economic consequence of family breakdown, the promotion of self-sufficiency remains a key component of support law. Treating the divorced couple as a single unit flies in the face of this development. Second, if one takes the view to its logical conclusion, it appears that once you are spouses under the Act, then you remain a spousal unit forever. Neither separation, divorce, or even remarriage by one or both of the parties, can dissolve the "family", at least insofar as the inclusion/deduction rules with respect to spousal support apply to them.

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[199] [1995] 1 C.T.C. 382 (hereinafter *Thibaudeau*)

[200] *Ibid.* at 410. This characterisation of separated or divorced parents can be contrasted to that of McLachlin J. who describes them as "the fractured family" (at 418).

[201] *Ibid.* at 403.

It is not surprising that there have been several calls for reform of, and in some cases, repeal of the inclusion/deduction system as it applies to spousal support. In 1987, the Canadian Advisory Council on the Status of Women recommended that the deduction be converted to a tax credit and that the inclusion requirement be repealed.[203] Since that time both the Ontario Fair Tax Commission and Maureen Maloney have called for the outright repeal of the inclusion/deduction system.[204] I endorse this latter recommendation on the basis that there is no tax policy or other compelling justification for the retention of the inclusion/deduction system. The current rules do not accomplish their intended purpose, and they impose a significant hardship on many women who find themselves descending into poverty as a result of both their divorce or separation and the impact of the requirement to include spousal support in income. There is a precedent for the repeal of these rules. Even though Suzanne Thibaudeau was unsuccessful in her attempt to have the inclusion/deduction system with respect to child support payments struck down as being in contravention of section 15(1) of the *Charter*, the federal government has since enacted legislation that has abolished the inclusion/deduction

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[202] (1992) 43 R.F.L. 3d. 345.

[203] Maloney, *supra* note 83 at 23.

[204] Ontario Fair Tax Commission, *supra* note 88 at 276 and Maloney, *supra* note 103 at 135.

system for all child support orders made or varied on or after May 1, 1997.[205] Repeal of the inclusion/deduction system with respect to spousal support is a logical next step.

VII. JOINT LIABILITY

Section 160(1) is a broad ranging provision that provides that where property is transferred to a spouse, a former spouse, a person under 18 or a person with whom the taxpayer does not deal at arm's length, the transferor and the transferee are jointly liable for any tax owing by the transferor as a result of the transaction. Given the breadth of its ambit, the provision would also apply to all transactions between, for example, parents and their adult children because they do not deal at arm's length with each other. The purpose of the provision is to ensure that tax owing as a result of intra-family transfers of property is paid. It is important to note that because many transfers of capital property between spouses take place on a tax-free basis by virtue of one of the rollover provisions, this rule will only apply in respect of the transfer of non-capital property or capital property to which a rollover does not apply. But there are problems with this provision. First, it assumes that spouses, former spouses and other related persons are one person for the purposes of taxes owing by one of them in respect of a transfer of property to the other. Given that most of the transfers between spouses and former spouses are probably transfers by men to women, this provision has a particularly negative impact on women. It undermines the autonomy of women by treating them as part of the spousal unit and not as individuals. It may also impose a financial hardship on women who may not have the funds with which to pay the taxes owed by their male spouse. It affects the control that women have over the property that has been transferred to them because it is possible that the property will have to be sold or mortgaged to pay the taxes owing as a result of the transfer. It is an especially harsh rule insofar as it applies to former spouses. To treat a woman as responsible for her former spouse's tax liability is unacceptable. It means that even though the spousal relationship is over and the separation has been recognized by way of a divorce or separation agreement, for tax purposes the former spouses remain a spousal unit. Such a provision flies in the face of any concept or former spouses becoming independent of each other. In light of these problems, section 160 should be repealed and Revenue Canada should rely on their existing tax collection practices.

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[205] S.C. 1997 c.25.

VIII. SPOUSAL TRUSTS

The most important tax rules that apply to spousal trusts are those which permit the transfer of capital property by a taxpayer to a trust of which the taxpayer's spouse is a beneficiary on a rollover basis. The rollover may occur on an *inter vivos* basis[206] or on death of the taxpayer.[207] In each case, however, the trust must meet strict requirements in order to qualify as a spousal trust for the purposes of the rollover. The capital property must vest indefeasibly in the trust, the spouse must be entitled to receive all of the income of the trust and no person other than the spouse may, before the death of the spouse, receive or otherwise obtain the use of the income or capital of the trust. The problem with the rule is that as Neil Brooks states:

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[206] Section 73(1) of the Act.

[207] Section 70(6) of the Act.

> [it] allows a husband to determine the ultimate beneficiary of his legal property, while at the same time obtaining a deferral of the tax on any accrued gain until his wife dies, so long as he leaves her a life interest. The fact that the wife does not have any say over who the ultimate beneficiary will be, or even in the details of the income interest to ensure that it provides her with a fair return on the capital of the trust, would appear to negate any notion that the property was 'marital' property.[206]

A case can be made that, even if the other rules that permit a rollover of capital property to a spouse remain in the Act, the rollover to a spousal trust should be repealed. The reason is that tax incentives should not be given to taxpayers for transactions which ensure that women will be excluded from any legal ownership of property that was formerly owned by their spouse.

IX. CONSEQUENTIAL

The consequential provisions listed in Appendix A relate to the substantive rules that apply to spousal and familial relationships. Whether these rules should be retained or repealed depends on the fate of the substantive rules to which the consequential provisions relate. Nevertheless, it is important to include the consequential provisions in Appendix A in order to present a comprehensive and complete list of all provisions that apply to spousal and familial relationships.

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[206] Brooks, *supra* note 82 at 77.

CONCLUSION

The preceding analysis has considered the issue of the recognition by the tax system of spousal and familial relationships for a variety of purposes. The analysis has taken into account the underlying purposes of the tax system and the basic tenets of tax policy analysis. In addition it has adopted an "equality" perspective by evaluating the impact of the respective tax provisions on different groups in society in order to determine whether these rules operate fairly. The background to the analysis has been the changing demographics of the family in Canada today, including a decrease in marriage rates, an increase in the number of lone parent families and an increased state recognition of lesbian and gay relationships. Taken together with changes in the labour force, including the increased participation of women, these social and economic factors form the backdrop to the analysis.

The report tracks the legislative history of some of the key tax rules that take spousal and familial relationships into account. It classifies each rule by reference to the tax policy rationales underlying the rules and the critique of the rules is based on this classification. The critique takes the most important rules in each category and reviews the operation and intent of each rule. The analysis of the rule draws on a rich variety of primarily Canadian tax policy literature and discusses the problems with each rule. In some instances, suggestions are made for changes to a rule in order to make it fairer and in other cases, repeal of a particular rule is recommended.

Perhaps the most persuasive reason for moving away from rules that take spousal and familial relationships into account is that these rules complicate the tax system. If simplicity really is an underlying goal of the income tax system, then repeal of many of these rules would enhance that objective considerably. The integrity of the individual as the unit would be ensured and there would be other benefits. Writing about the rules that treat spouses as one unit, Jack London notes that they:

> [e]xacerbate the schizophrenic and incoherent focus of the tax system on who should comprise the appropriate human tax units. The federal income tax system, more than ever before, lacks an intellectually or rationally defensible perspective on whether married persons are, or ought to be, considered tax units... In the result, the system is less equitable, both horizontally and vertically, than it could be, or than it would be, under an ideal tax system, when *only* tax equities are considered.[209]

But repeal of all the rules that refer to "spouse" or "child" is not recommended. Some of the rules have an important objective and are effective in accomplishing that objective. In other instances it is difficult to determine if a rule is achieving its intended objective. Therefore, in some cases the report recommends the collection of more empirical data in order to reach a conclusion about the effectiveness (or lack thereof) of a particular rule.

Some of the major issues raised by the report include the following. While the attribution rules are intended to stop income splitting between spouses and between adults and minor children, there is a dearth of information about whether, in the absence of the rules, there would be a proliferation of income splitting transactions with a consequent tax leakage. Repeal of the rules would be a positive move to the extent that it results in a removal of the disincentive for high-income taxpayers (primarily men) to transfer property to their low-income spouses (primarily women). The problem is that repeal of the attribution rules would only benefit those who have high incomes and who own income-producing property. The report recommends more empirical research on the issue of the cost in terms of tax dollars lost through income splitting in the absence of the rules before a decision is made about retention or repeal of the rules.

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[209] Jack London, "The Impact of Changing Perceptions of Social Equity on Tax Policy: The Marital Tax Unit", (1988) 26 *Osgoode Hall Law Journal* 287 at 288-289.

The report recommends the repeal of rules that are based on dependency. These rules include the spousal tax credit and the ability to transfer unused tax credits to a spouse. The primary reasons for this recommendation are that these rules undermine women's autonomy, they act as a disincentive to women's participation in the paid labour force and the tax subsidy is delivered to the economically dominant person in the relationship and not the person who needs it. Provisions based on economies of scale are subject to the critique that it is not only spouses who benefit from economies of scale. Any two or more persons living together benefit, but they are not penalized by the tax system. In this context the child-care expense deduction, the GST Tax Credit and the Canada Child Tax Benefit are discussed in detail and recommendations for improvement made.

The provisions that are based on economic mutuality are discussed in some detail. These provisions are subdivided into those that are of advantage to the taxpayer because they result in less tax payable and those that disadvantage the taxpayer because they increase the amount of taxes payable. These two main classifications are further subdivided into other classifications that look to the nature of the provision. The problem with rules that are based on an assumption of economic mutuality is that in many spousal relationships, this economic mutuality is not a reality. There is little or no sharing or pooling of income. Therefore, unless the provision has an underlying other rationale, it is difficult to argue that it should form part of the tax system. The conclusion is that some of the rules that advantage the taxpayer should be retained because they do have valid other objectives. But rules such as the inclusion/deduction system with respect to spousal support cannot be defended on any basis.

In summary, there are many reasons why tax rules that take spousal and familial relationships into account should be rethought. Perhaps the most compelling reason is that the nature of spousal and familial relationships has changed dramatically over the years. The percentage of Canadians who are married or living in heterosexual common-law relationships is declining. Within those relationships, the role of spouses is changing. Other non-spousal relationships, such as mother and daughter or two or more good friends, share many characteristics with spousal relationships. Yet it is spousal relationships that the tax system treats differently. It is time that this policy was reconsidered and this report is intended to facilitate that reconsideration.

TABLE 1

SUMMARY OF KEY RECOMMENDATIONS

[redacted]

SECTION	**COMMENTS**
DEPENDENCY PROVISIONS: SS.118(1)(A), 118.8	➢ The dependency provisions affirm that a woman's dependency on a man deserves tax relief. This undermines the autonomy of women and results in a certain privatisation of economic responsibility for dependent persons. ➢ In the case of the spousal tax credit, the tax subsidy is delivered to the economically dominant person in the relationship and not the "dependent" person who needs it. This manner of delivery assumes that income is pooled and wealth distributed equally within the relationship. However, studies show that this assumption is simply false. ➢ Provisions based on dependency are a disincentive to women's participation in the paid labour force, which is exacerbated by other costs incurred by women who choose to work outside the home. ➢ There is no reason to consider that an individual supporting a dependent has a reduced ability to pay. Indeed their ability to pay may well be increased because there is no need to have recourse to the private market in order to obtain the services provided in the home by the dependent person in the relationship. ➢ The provision of the credit to the economically dominant person in a relationship ignores the benefit that accrues to the individual from work performed in the home by the person whom they support. ➢ The living arrangements of taxpayers have changed considerably since the introduction of provisions such as the spousal tax credit.

CANADA CHILD TAX BENEFIT: SS.122.6 TO 122.64	➢ The family allowance portion of the CCTB should be removed from the tax system and delivered by way of a direct grant. ➢ One of the major weaknesses of the CCTB is its limited application. The benefit is targeted at the working poor and does not address directly the needs of those women with children who receive social assistance. Yet, in many instances it is women on social assistance who are most in need of financial assistance. ➢ The targeting of the CCTB at the working poor has a disadvantageous impact on women with disabilities who have dependent children, due to the additional barriers to paid employment that these women face. ➢ The reduction in the amount of the CCTB by 25% of any child care expenses deducted under section 63 of the Act is an added and unfair burden for those women who need child care to participate in the paid labour force. ➢ Unfortunately many women are not claiming the benefits to which they are entitled. Because the CCTB is delivered as a refundable tax credit, payment depends on an individual filing a tax return and claiming the credit. In the case of an individual with a spouse, the spouse must also file a return because the amount of the CCTB is based on a calculation that takes "family" income into account. ➢ Low income women who need the CCTB most are least likely to claim the credit. Because their income is so low these women do not pay tax and therefore are less likely to complete a tax return.
PROVISIONS RELATED TO DIVORCE AND SEPARATION: S.56(1)(B), 60(B)	➢ The current rules impose a significant hardship on many women who find themselves descending into poverty as a result of both their divorce or separation and the impact of the requirement to include spousal support in income. ➢ Support awards, even when "grossed up," often do not compensate the recipient for her increased tax liability. ➢ Because entitlements to credits such as the GST tax credit and the CCTB decreases as income increases, the inclusion in income of an award may have the adverse result of reducing the amount of those credits for the recipient of spousal support. ➢ Although the inclusion/deduction system is often justified as an enforcement measure, by providing an incentive for men to make support payments, this justification is inadequate. Up to 85% of all orders for the support of women and children remain unpaid or in arrears.

	➢ From a tax policy perspective, the system makes no sense. The income tax system operates on the basis that only income with a source, such as employment, business or property, is taxed. Windfall gains and other unearned income is not taxed. Spousal support does not have a source, and the only reason that it is included in income is because it is deductible to the payor. ➢ The inclusion/deduction system delivers a subsidy to two individuals who are no longer spouses and yet who, for the purposes of the Act, are treated as one tax unit. This is at odds with one of the objectives of family law, which is to promote "clean break" or self-sufficiency of spouses after separation or divorce.
JOINT LIABILITY: S.160(1)	➢ The rule assumes that spouses, former spouses and other related persons are one person for the purposes of taxes owing by one of them in respect of a transfer of property to the other. Given that most of the transfers between spouses and former spouses are probably transfers by men to women, this provision has a particularly negative impact on women. ➢ Revenue Canada should rely on their existing tax collection practices to ensure that tax owing as a result of intra-family transfers of property is paid.
SPOUSAL TRUSTS: SS.70(6) AND 73(1)	➢ Even if the other rules that permit a rollover of capital property to a spouse remain in the Act, the rollover to a spousal trust should be repealed. Tax incentives should not be given to taxpayers for transactions which ensure that women will be excluded from any legal ownership of property that was formerly owned by their spouse.

[redacted]

SECTION	**COMMENTS**
CHILD CARE EXPENSE DEDUCTION: s. 63	➢ To make the child care expense deduction fairer, it should be converted to a refundable tax credit, that does not take family income into account. This measure would mean that the income level of the recipient would be irrelevant in determining the amount of the subsidy. ➢ The amount of the deduction is inadequate. The monetary limitations on the amount that may be deducted are further exacerbated by the rule requiring the spouse with the lower income to take the deduction. Since the deduction is applied to reduce income that is taxed at a lower rate, the resulting tax savings is lower than it would be if taken by the high rate taxpayer. ➢ The limitation on who may take the deduction is arbitrarily dependent on the marginal tax rates of the spouses, and does not take into account the cost or nature of the child-care received. ➢ Since s.63 provides a deduction from income, the value of the deduction is tied to the taxpayer's marginal tax rate. This means that an individual paying tax at a high rate receives a larger tax subsidy than an individual paying at a lower rate. The deduction is worthless to those who have little or no income to which to apply the deduction. Such a system establishes a hierarchy of taxpayers that is in inverse relation to their ability to pay for child care. ➢ The issue of whether the tax system would be used to fund child-care or whether the government should move towards a system that provides state funded child-care centres for young children is an important issue for further debate.

SECTION	**COMMENTS**
GST TAX CREDIT: S.122.5 AND CANADA CHILD TAX BENEFIT: SS. 122.6 TO 122.64	➢ To remove the aggregation of income inherent in the GST tax credit and the CCTB would fly in the face of the intent of the provisions which is to provide subsidies to those with low incomes. Therefore the subsidies should remain in the Act.
ROLLOVER PROVISIONS (ON DEATH): S. 70(6)	➢ While it is unclear whether the inter vivos rollover rules actually encourage the redistribution of wealth from men to women in the spousal relationship, we do know that the rollover on death is a significant incentive to taxpayers to bequeath capital property to their spouses. Therefore the provision aids in the redistribution of wealth from men to women.
TAX FREE TRANSFERS OF FARMING PROPERTY TO A CHILD TAXPAYER: SS.70(9), 70(9.2), 73(3) AND 73(4)	➢ These rules permit the family farm to be passed from generation to generation without the transferor being taxed on any gain that has accrued to the property, and therefore serve an important role in preserving the "family" farm. ➢ Because the transfer of the family farm to a child is often a non-cash transaction, the tax liability that would arise in the absence of the rollover might be difficult to satisfy.
PROVISIONS IN RESPECT OF RETIREMENT SAVINGS AND PENSIONS: 147(19), 146(8.1) AND REGULATION 8501.	➢ Until measures to improve access to pensions are introduced, the current rules in respect of spouses should be retained. Even though they are flawed and inadequate, they do assist some women to secure income in retirement. ➢ The general policy underlying these rules is to permit taxpayers to provide for retirement income for their spouses (primarily women) who are unable to contribute to a RPP or a RRSP on their own behalf.

	➢ Women's ability to benefit from tax subsidies for RPPs is limited by their lack of participation in the paid labour force and by the kind of work that women do. Those women who work part-time, in non-unionized jobs or for small employers unable to finance these plans, or those who are self-employed or unemployed, do not benefit from these subsidies. ➢ Women who do not have access to work related pension plans may contribute to RRSPs, but given that women tend to earn considerably less than men, they tend to have less discretionary income to contribute to an RRSP. ➢ Since women have less access to private pension plans, some would argue that all tax preferences for retirement saving should be removed from the Act and that the public pensions be strengthened and improved. Unfortunately, political reality appears to suggest that in the current climate it is unlikely that more resources will be devoted to bolstering public pensions. ➢ Thought should be given to ways to improve these subsidies that might depart from the current policy of giving preferential tax treatment to those in spousal relationships.
PRINCIPAL RESIDENCE EXEMPTION: s.40(2)	➢ Given the tremendous tax savings that the principal residence exemption generates, the limit of one principal residence designation per family for each year is sensible. ➢ The argument that provisions that are based on relationships of economic mutuality are problematic because they do not reflect the reality of relationships in which there may not be a sharing of wealth is not as persuasive with respect to the principal residence exemption, given that the family home tends to be enjoyed equally by both spouses, and often is jointly owned.

SECTION	**COMMENTS**
ATTRIBUTION RULES: SS.74.1, 74.2, 56(2) AND (4)	➢ Without any empirical data, it is difficult to determine whether there would be a significant increase in income splitting in the absence of these rules. ➢ A related question is whether there would be a concomitant increase in the transfer of property by men to women that would have the advantage of addressing women's lack of income relative to men.
ROLLOVER PROVISIONS (INTER VIVOS): 73(1)	➢ These rules are intended to encourage the redistribution of capital property and wealth within a spousal relationship and, in particular, from men to women. The key question is how effective are the rules in accomplishing this end? ➢ Before consideration is given to a repeal of or amendment to these rules, empirical data must be collected in order to determine whether these transfers of capital property by men to women are actually taking place. If not, more direct state intervention designed to encourage redistribution of wealth between men and women may be appropriate.

APPENDIX A

REFERENCES TO SPOUSE, MARRIED PERSON AND CHILD IN THE *INCOME TAX ACT*

The following material lists and describes the operation of every provision in the Act that refers to "spouse", "married person" or "child". Each provision has been classified in a manner that best reflects the intention of the provision. In some instances the same provision is listed in more than one category because it has a dual purpose. The classification is as follows:

1. Anti-avoidance rules
2. Administrative provisions
3. Definitional provisions
4. Dependency related provisions
5. Provisions that recognize economies of scale and reduce the amount of the tax subsidy
6. Provisions that are based on an assumption of economic mutuality, that provide a tax preference and that are in respect of
    - i) employment
    - ii) the family farm or family corporation
    - iii) corporations and business partnerships
    - iv) the family home

  v) the death of the taxpayer
  vi) *inter vivos* transfers of property
  vii) health and education
  viii) retirement and pensions
  ix) divorce or separation
  x) miscellaneous

7. Provisions that are based on an assumption of economic mutuality, that are to the disadvantage of the spouse because they result in an increase in tax liability and that are in respect of
  i) corporations and business activity
  ii) the family home
  iii) the disposition of capital property
  iv) divorce or separation
  v) retirement and pensions
  vi) miscellaneous
8. Provisions that impose a joint liability on spouses
9. Provisions that relate to spousal trusts
10. Consequential provisions

I. ANTI-AVOIDANCE RULES

A. Spouse

Section 74.1

Section 74.1 provides detailed rules that attribute to the transferor or lender income or loss from property transferred at less than fair market value or property that is loaned to a spouse. The intention of the rules is to eliminate income splitting between spouses. Income splitting occurs when the spouse with the higher income transfers income producing property to a spouse with less income who correspondingly pays tax at a lower rate on that income than the rate at which the spouse with the higher income would pay tax.

Section 74.2(1)

Section 74.2 provides detailed rules that attribute to the transferor or lender any capital gain or capital loss from the disposition of property transferred at less than fair market value or loaned to a spouse. The provision is intended to stop spouses splitting capital gains.

Section 74.5(1)

Section 74.5 contains detailed provisions that are part of the attribution rules. This section spells out the exceptions to the rules and includes many anti-avoidance rules that are intended to ensure that the attribution rules cannot be avoided through inappropriate tax planning such as the use of back to back loans, guarantees and artificial transactions.

Section 104(5.4) (b)

Section 104(5.3) provides for the deferral of the 21-year deemed disposition for some trusts. (All trusts are deemed to dispose of their capital property every 21 years in order that tax can be levied on any appreciation in the value of that property.) Subsection (5.4) defines an exempt beneficiary for those purposes but will soon be irrelevant as subsection (5.3) is to be repealed.

Section 104(5.8) (a)(i)(C), (b)

Section 104(5.8) is an anti-avoidance rule designed to prevent the avoidance of the 21 year deemed disposition rules through the use of trust to trust transfers and it applies to spousal trusts as well as other non-spousal trusts.

Section 104(6)(b)(i)(D), (b)(ii) and (iii)

Section 104(6) provides for the deduction in the computation of trust income of any amount payable to a beneficiary. There are special rules that affect spousal trusts and that prohibit the deduction of any amount that is a distribution of capital of the trust to anyone other than the spouse.

Section 107(4)(b), (c) and (d) to (f) (proposed amendment)

Section 107(4) applies to post 1971 spousal trusts and provides that where such a trust distributes capital property, resource property or land to a beneficiary other than the beneficiary spouse, the property is deemed to be disposed of a fair market value.

Section 146(8.3)

Section 146(8.3) contains an anti-avoidance attribution rule intended to stop spouses income splitting by having an individual contribute to an RRSP from which the spouse withdraws the amount. The withdrawal will be taxed to the individual and not the spouse.

Section 212.1(3)(b)(i)

Section 212.1 is an anti-avoidance rule that prevents the removal of taxable corporate surplus as a tax-free return of capital through a non-arm's length transfer by a non-resident of shares from one Canadian corporation to another. Subsection (3) effectively treats the shares of one spouse as the shares of the other spouse.

B. Child

Section 75.1(1)(a) and (2) definition of "child"

Section 75.1 is an attribution rule that applies where farm property was transferred to a child pursuant to section 73 on a rollover basis and the child disposed of the property before the child attained 18 years of age. In those circumstances any capital gain is attributed to the transferor.

II. ADMINISTRATIVE PROVISIONS

A. Spouse

Section 122.62(5), (6) and (7)

Section 122.62 provides that in order to qualify for the Canada Child Tax Benefit, an eligible individual must file a notice with the Minister. Subsections (5), (6) and (7) deal with the situations where the cohabiting spouse of the eligible individual dies, the individual separates from the cohabiting spouse and a person becomes the cohabiting spouse respectively.

Section 126(7)(g) definition of "non-business-income tax"

Section 126(7)(g) defines non-business-income tax for the purposes of computing a taxpayer's entitlement to the foreign tax credit. Non-business-income tax does not include a tax that can be attributed to a taxable capital gain in respect of which the taxpayer or the taxpayer's spouse claimed the capital gains exemption.

Section 150(1)(d)(ii)(B), (d)(iii)

Section 150 provides the rules respecting the date for filing of tax returns. Subsection (1)(d) requires that individuals file their return by April 30 of the year following the taxation year. In the case of an individual carrying on business in the year, the return and that of a cohabiting spouse must be filed by June 15 of the year following the taxation year.

Section 221(1)(i)

Section 221 permits the Governor in Council to make regulations under the Act and subsection (1)(i) permit regulations to be made which define the classes of non-resident persons who may be regarded as spouses under the Act.

Section 248(22)(a) and (b)

Section 248(22) provides that where property could on dissolution of a matrimonial regime be the subject of partition, the property shall be deemed to be owned by the spouse who originally owned it and in any other case, shall be deemed to be owned by the spouse who had administration of the property.

Section 248(23)

Section 248(23) provides that where, after dissolution of a matrimonial regime the owner of property is not the person deemed to have been the owner under subsection (22), then the person is deemed to have transferred the property to the person's spouse immediately before the dissolution of the matrimonial regime.

B. Married Person

Section 143(4)(b) definition of "family"

Section 143 is intended to provide a level of taxation for communal organizations such as Hutterite colonies that is roughly comparable to the general tax treatment of other farming families. A formula is applied to determine how much income of the communal organization is attributed to each member. The definition of family provides that a family includes in the case of a married adult, that person and the person's spouse and the unmarried children of both of them who are not adults.

III. DEFINITIONAL PROVISIONS

A. Spouse

Section 248(1) definitions of "death benefit", "home relocation loan," and "separation agreement"

The definition of "death benefit" means that a surviving spouse may receive up to $10,000 of an amount that is considered to be a death benefit tax-free. The definition of "home relocation loan" means that a loan received by the taxpayer or the taxpayer's spouse for the purpose of acquiring a home is not taxable. The definition of "separation agreement" is relevant for the purposes of the rules that require the inclusion and permit the deduction of spousal support payments.

Section 248(8)(a) and (b)

Section 248(8) provides rules that expand the concept of "a transfer as a consequence of death" for the purposes of several rollover provisions that apply on death. Paragraphs (a) and (b) ensure that the rules apply to a transfer by a taxpayer or the taxpayer's spouse.

Section 252(1)(c), (e) and (2)(a)(iii), and (b) to (g).

Section 251(1) provides the extended definition of "child" and that definition includes a child of the taxpayer's spouse and a spouse of the child of the taxpayer. Subsection (2) extends the meaning of different relationships. A parent of a taxpayer includes a person who is the parent of the taxpayer's spouse. A brother of a taxpayer includes a person who is the brother of the taxpayer's spouse or the spouse of a taxpayer's sister. A sister of the taxpayer includes a person who is the sister of the taxpayer's spouse and the spouse of the taxpayer's brother. A grandparent of the taxpayer includes a grandparent of the taxpayer's spouse and the spouse of the taxpayer's grandparent. An aunt or great-aunt of a taxpayer includes the spouse of the taxpayer's uncle or great-uncle. An uncle or great-uncle of a taxpayer includes the spouse of the taxpayer's aunt or great-aunt. A niece or nephew of a taxpayer includes the niece or nephew of the taxpayer's spouse. All of these definitions are relevant any time the Act refers to related persons.

Section 252(3) and (4)(a), (c), and (d)

Section 252(3) extends the meaning of "spouse" and "former spouse" of an individual (for certain listed sections of the Act) to include another individual of the opposite sex who is a party to a voidable or void marriage with the individual. Subsection (4) is the definition of spouse which currently includes a person of the opposite sex cohabiting in a conjugal relationship with another person where they have so cohabited for a 12 month period or are the parents of a child. Subsection (4) also provides that references to marriage in the Act are to be read as if the relationship between 2 spouses were a marriage and that provisions that apply to a married person apply to a spouse. Provisions that apply to an unmarried person do not apply to a spouse.

B. Married Person

Section 251(6)(b)

Section 251 provides that related persons are individuals connected by blood, marriage or adoption. Subsection (6) provides that persons are connected by marriage if one is married to the other or to a person who is so connected by blood relationship to the other.

Section 252(4)(c)

Section 252(4)(c) provides that provisions that apply to a person who is married apply to a person who is the spouse of the taxpayer.

C. Child

Section 122.5(1) (b) definitions of "eligible individual" and "qualified dependant"

For the purposes of the GST tax credit, an eligible individual includes a parent of a child and a qualified dependant includes a child of the individual.

IV. DEPENDENCY RELATED PROVISIONS

A. Spouse

Section 8(1)(e)(ii)

Section 8(1)(e) provides a deduction in the computation of employment income given to railway employees for expenses for meals and lodging while away from the municipality where the employees home terminal is located and while working at a location from which the employee could not reasonably be expected to return daily to their own residence where they supported a spouse (or person dependent on the taxpayer for support and connected to the taxpayer by blood, marriage or adoption).

Section 118 (1) (a), (1)B(a)(i) and (ii)

Section 118(1)(a) provides for the marital (spousal) tax credit which gives a tax credit to an individual supporting their spouse.

Section 118(1)(b) (Proposed amendment)

Section 118(1)(b) provides for the equivalent to spouse tax credit that gives a tax credit to an individual who supports a person such as a child or other person who is wholly dependent on the individual. The equivalent to spouse credit may not be claimed by a person who claims the spousal tax credit.

Section 118(1)(B)(b.1)(ii)(B)(II) (Proposed amendment)

This provision provides a supplement of $500 to various tax credits, including the spousal tax credit and the equivalent to spousal tax credit.

Section 118(6)

Section 118(6) defines a dependant for the purposes of the dependant tax credit and the infirm dependant tax credit as a person dependant on the individual and who is one of several particular relations of the individual or of the individual's spouse listed in the section.

Section 118.2(1)D(a), D(b) (Proposed amendment), (2)(a), (b), (b.1)(iii), (c)(ii), (l.8), (q), (2)(l.9), (l.10) proposed addition

Section 118.2 provides the medical expense tax credit. Any unused portion of a taxpayer's medical expense tax credit may be transferred to their spouse which means that either spouse may claim the tax credit for medical expenses incurred by the spouses. In addition proposed amendments provide that eligible medical expenses will include expenses for training courses relating to the care of a mentally or physically infirm person who is related to the taxpayer and is either a member of the taxpayer's household or is dependent on the individual for support.

Section 118.3(2) (a)

Section 118.3(2)(a) provides criteria for determining the entitlement of a supporting individual of a disabled person to claim that person's unused disability tax credit. Such a transfer is allowed if the individual is allowed the equivalent to spouse tax credit in respect of the disabled person.

Section 118.61(1)(E)

Section 118.61 provides the formula to calculate the unused portion of a taxpayer's tuition and education tax credits that may be transferred to a spouse, parent or grandparent under section 118.8.

Section 118.8 and section 118.8C(a) (Proposed amendment)

Section 118.8 provides for the transfer of the unused portion of the tuition and education tax credits, and the age, pension and disability tax credits to a spouse.

Section 118.9

Section 118.9 provides that if the individual's spouse does not deduct any unused portion of the tuition or education tax credit, a parent or grandparent may deduct that amount.

B. Married Person

Section 118 (1)(a), (1)B(a)(i) and (ii)

Section 118(1)(a) provides for the marital (spousal) tax credit which gives a tax credit to an individual supporting their spouse.

Section 118(1)(b) (Proposed amendment)

Section 118(1)(b) provides for the equivalent to spouse tax credit that gives a tax credit to an individual who supports a person such as a child or other person who is wholly dependent on the individual. The equivalent to spouse credit may not be claimed by a person who claims the spousal tax credit.

Section 118.8 and section 118.8C(a) (Proposed amendment)

Section 118.8 provides for the transfer of the unused portion of the tuition and education tax credits, and the age, pension and disability tax credits to a spouse and still retains the reference to "married person".

C. Child

Section 6(1)(b)(ix)

Section 6(1)(b) provides for the inclusion in employment income of amounts received as allowances. Subparagraph (ix) provides that an allowance received from the employer by an employee employed in a remote location which is in respect of expenses incurred by reason of the child of the employee having to live away from the employee's home to attend school is an excluded allowance that is not required to be included in employment income.

Section 60(l)(v)(B.1)(II)

Section 60(l) permits the tax free rollover of a refund of premiums from a registered retirement savings plan (RRSP) to an annuity for a dependent child on death of the RRSP contributor.

Section 63(1), (2), (2.1), (2.2)(b), (2.3)(a),(c),(e), (3) and (b) (Proposed amendment to the definition of "eligible child") and (4)

Section 63 provides for the deduction of child care expenses in certain circumstances. An eligible child for the purposes of the deduction is a child of the taxpayer or the taxpayer's spouse or a child who is dependent on the taxpayer or the taxpayer's spouse and has limited income or who is dependent on the taxpayer or taxpayer's spouse because of a mental or physical infirmity.

Section 108(1)(b)(iii) definition of "preferred beneficiary"

A trust may allocate income to a preferred beneficiary and even though the amount is not paid to that beneficiary, the amount is taxed in the hands of the preferred beneficiary. This rule allows for income splitting between a trust and preferred beneficiaries. A preferred beneficiary includes children of the settlor who suffer from a mental or physical infirmity.

Section 118(1)(B)(b.1)(ii)(A),(B)(II) (Proposed amendment), (c.1)(ii), and (6)(a)

Section 118(1)B provides the equivalent to spousal tax credit and this credit may be claimed in respect of a child who is dependent on the taxpayer for support provided that the spousal tax credit is not claimed by the taxpayer. Section 118(1)(c.1) provides the caregiver tax credit to a child or grandchild of a person over 65 who is infirm.

Section 118.3(2)(a)(i)(B)

Section 118.3(2)(a) provides criteria for determining the entitlement of a supporting individual of a disabled person to claim that person's unused disability tax credit. Such a transfer is allowed if the individual is a child of the disabled person who is allowed the caregiver tax credit in respect of the disabled person.

Section 122.61(1)

Section 122.61(1) provides the Canada Child Tax Benefit, a refundable tax credit payable on a monthly basis to the parent who is the primary caregiver of the child. The amount of the payment is reduced and eventually eliminated as annual family income increases.

IV. ECONOMIES OF SCALE AND REDUCTION IN THE AMOUNT OF THE TAX SUBSIDY

A. Spouse

Section 56(1)(s)(i) and (ii)

Section 56 (1) (s) requires the inclusion in income of certain grants made under federal government programs respecting home insulation or energy conservation. In the case of spouses who are living together in the year that such a grant is received by one of them the grant is to be included in the income of the spouse with the higher income in that year.

Section 56(1)(u)(i) and (ii)

Section 56(1)(u) requires the inclusion in income of social assistance payments and, in the case of spouses living together, the amount is included in the income of the spouse with the higher income in that year.

Section 63(3), definition of "eligible child", (a), (b) (including proposed amendment), (d), and definition of "supporting person" (b)

Section 63 provides a deduction for child care expenses in certain circumstances. An eligible child for the purposes of the deduction is a child of the taxpayer or the taxpayer's spouse or a child who is dependent on the taxpayer or the taxpayer's spouse and has limited income or who is dependent on the taxpayer or taxpayer's spouse because of a mental or physical infirmity. The section also provides that the deduction must be taken by the spouse (in two spouse families) with the lower income, although there are some exceptions to this rule.

Section 122.5(1) definition of "qualified relation"

For the purposes of the GST tax credit, a qualified relation is the spouse of an individual. Entitlement to the GST tax credit is based on "family" income meaning that the income of spouses is aggregated to determine their entitlement to the GST tax credit. The result is that each spouse may receive less than they would if they did not have a spouse. Furthermore, individuals under 19 years of age are eligible for the GST tax credit if they are married.

Section 122.6 (c) definitions of "adjusted income", "cohabiting spouse", "eligible individual" and (e) "qualified dependant"

These definitions are relevant for the purposes of combining the income of spouses for the purposes of entitlement to the Canada Child Tax Benefit, which is an income tested refundable tax credit based on family income comprising of two components, the CCTB basic benefit and the CCTB National Child Benefit Supplement.

VI. PROVISIONS THAT ARE BASED ON AN ASSUMPTION OF ECONOMIC MUTUALITY AND THAT ARE OF ADVANTAGE TO THE TAXPAYER

A. Employment related

1. Spouse

Section 15(2.4) (b) and (e)

Section 15(2), which requires the inclusion in income of certain shareholder debt, does not apply to a "home relocation loan" in respect of an individual who is the spouse of an employee of the lender to enable the individual to purchase a home where it is reasonable to conclude that the employee's spouse received the loan because of the employee's employment.

PROPOSED section 20.01(1), (2)(c), and (3)(a), to apply to fiscal periods ending after 1997

Section 20.01 permits an individual to deduct in the computation of business income premiums payable under a private health services plan for the coverage of the individual, the individual's spouse and members of the individual's household. Certain limits apply to the amount deductible and those limits also apply to contributions for the individual's spouse.

Section 54.1(1)

Section 54.1 provides that a taxpayer who does not ordinarily inhabit their principal residence because either the taxpayer or their spouse has been transferred by their employer may elect that the house remains their principal residence until the taxpayer re-occupies the house or the taxpayer dies during the term of the taxpayer's or the spouse's employment by the employer who required the relocation.

Section 62(3)(f)

Section 62 permits the deduction of certain moving expenses. Subsection (3)(f) lists eligible moving expenses, one of which is the cost to the taxpayer of legal costs in respect of the purchase of a new residence where the old residence was sold by the taxpayer or the taxpayer's spouse as a result of the move.

Section 248(1) definition of "home relocation loan"

The definition of "home relocation loan" means that a loan received by the taxpayer or the taxpayer's spouse from the taxpayer's employer to purchase a home is not taxable.

Section 250(2)

Section 250 provides the circumstance under which members of the armed forces, ambassadors and other listed government officials shall be deemed to be resident in Canada. Subsection (2) provides that where any of these individuals cease to hold that office that entitles them to resident status, the person and their spouse shall be deemed to have been resident in Canada throughout the part of the year preceding that time.

B. In respect of the family farm or family corporation

1. Spouse

Section 40(1.1)(a)

Section 40(1)(a)(iii) provides a reserve for deferred payments in respect of capital property. The formula used to calculate the amount of the reserve gives the taxpayer a reserve equal to the lesser of a reasonable reserve or 4/5 of the gain in year one, 3/5 of the gain in year two, 2/5 of the gain in year three and 1/5 of the gain in year four, with no entitlement to a reserve in the fifth year after disposition of the property. Section 40(1.1) provides that where the property is farming property used by the taxpayer or the taxpayer's spouse and it is disposed of to a child of the taxpayer, the formula described above is adjusted to 1/10 of the gain in year one (with a corresponding adjustment to the other years). It therefore increases the length of time that a reserve may be taken to 9 years after the sale.

Section 70(6.1), (9), (9.1), (9.3) and (9.8)

Section 70(6.1) provides for the rollover of a net income stabilization account from a deceased taxpayer to a spouse or spouse trust. Section 70(9) permits the transfer of certain farm properties to a child of the taxpayer at a value between cost and fair market value (thereby permitting a rollover) provided that the property was used principally in the business of farming by the deceased taxpayer, the taxpayer's spouse or any of the taxpayer's children on a regular and continuous basis prior to the taxpayer's death. Section 70(9.1) permits the transfer of certain farming properties from a spouse trust to the children of the settlor of the trust at a proceeds of disposition of an amount between cost and fair market value, thereby permitting a rollout of the property from the spouse trust. The idea is to ensure that if the taxpayer leaves farm property in trust for their spouse, that property can be transferred on death of the spouse on a tax-free basis to the children of the deceased taxpayer. Section 70(9.3) permits the transfer of a family farm corporation or partnership from a spouse trust to the children of the settlor of the trust on a tax-free basis. Section (9.8) provides that leased farm property is deemed to be used in the business of farming in certain circumstances.

Section 73(1), (2), (3), and (5)

Section 73 provides for the *inter vivos* transfer on a tax-free basis of different properties to a spouse. Subsection (1) permits the transfer of capital property to a spouse or former spouse on a rollover basis subject to certain conditions. Subsection (2) is an ancillary provision dealing with the transfer of depreciable capital property. Subsection (3) provides for the *inter vivos* transfer of farm property used principally in the business of farming by the taxpayer, the taxpayer's spouse or a child of the taxpayer to a child of the taxpayer. Subsection (5) provides for the rollover of a net income stabilization account from a taxpayer to a spouse or former spouse of the taxpayer.

Section 110.6 (1), definitions of "interest in a family farm partnership" (a)(i)(D) and (E), "qualified farm property" (a), (b), (c), "qualified small business corporation share" (a), and "share of the capital stock of a family farm corporation" (a)(i)

These definitions are all relevant for the calculation of the capital gains exemption. An exemption in the amount of $500,000 is available during the lifetime of a taxpayer in respect of capital gains realized on the disposition of properties that are considered to constitute the family farm. There is also a capital gains exemption for capital gains realized on the disposition of shares of a small business corporation. The references to spouse in the definitions relate to conditions that must be met in order for property to qualify as property eligible for the exemption. In the case of the family farm, the property must be used by the taxpayer or the taxpayer's spouse in order to be eligible for the exemption and in the case of the shares of a small business corporation, the shares must be owned by the taxpayer or the taxpayer's spouse in order to qualify.

Section 143(1), (2), (3) (Proposed amendment), (4)(b) definition of "family", and (5) (Proposed amendment)

Section 143 is intended to provide a level of taxation for communal organizations such as Hutterite colonies, that is roughly comparable to the general tax treatment of other farming families. A communal organization is treated as an *inter vivos* trust and may elect to make a deemed distribution of its income to its members so that the income is taxed with the member. A formula is applied to determine how much income is allocated to each member. The proposed amendments will allocate one full share of the income to the designated spouse and a half share of the income to the non-designated spouse instead of allocating twice the share of the income to the spouse designated by the congregation.

2. Married Person

Section 143(4)

See above entry under "spouse"

3. Child

Section 40 (1.1)

Section 40(1)(a)(iii) provides a reserve for deferred payments in respect of capital property. The formula used to calculate the amount of the reserve gives the taxpayer a reserve equal to the lesser of a reasonable reserve or 4/5 of the gain in year one, 3/5 of the gain in year two, 2/5 of the gain in year three and 1/5 of the gain in year four, with no entitlement to a reserve in the fifth year after disposition of the property. Section 40(1.1) provides that where the property is farming property used by the taxpayer or the taxpayer's spouse and it is disposed of to a child of the taxpayer, the formula described above is adjusted to 1/10 of the gain in year one (with a corresponding adjustment to the other years). It therefore increases the length of time that a reserve may be taken to 9 years after the sale.

Section 70(9), (9.1), (9.2), (9.3), (9.6) and (10), definitions of "child, "interest in a family farm partnership," and "share of the capital stock of a family farm corporation"

Section 70(9) permits the transfer of certain farm properties to a child of the taxpayer at a value between cost and fair market value (thereby permitting a rollover) provided that the property was used principally in the business of farming by the deceased taxpayer, the taxpayer's spouse or any of the taxpayer's children on a regular and continuous basis prior to the taxpayer's death. Section 70(9.1) permits the transfer of certain farming properties from a spouse trust to the children of the settlor of the trust at a proceeds of disposition of an amount between cost and fair market value, thereby permitting a rollout of the property from the spouse trust. The idea is to ensure that if the taxpayer leaves farm property in trust for their spouse, that property can be transferred on death of the spouse on a tax-free basis to the children of the deceased taxpayer. Section 70 (9.2) permits the transfer of family farm corporations and partnerships to a child of the taxpayer at a value between cost and fair market value (thereby permitting a rollover). Section 70(9.3) permits the transfer of a family farm corporation or partnership from a spouse trust to the children of the settlor of the trust on a tax-free basis. Section 70(9.6) provides for a "rollback" of the family farm from a child to a parent who was the spouse of the deceased on whose death the original rollover to the child occurred. Section 70(10) defines several terms relevant to these rules.

Section 73(3) (d), (d.1), (e), (4) (d)

Section 73(3) provides for the tax-free *inter vivos* transfer of farm property used principally in the business of farming by the taxpayer, the taxpayer's spouse or a child of the taxpayer to a child of the taxpayer. Section 73(4) provides for the tax-free *inter vivos* transfer of family farm corporations and partnerships to a child of the taxpayer.

Section 110.6(1) Definitions of "child," (a)(i)(D), (E) "interest in a family farm partnership" (a)(iii), (vi) and (vii), "qualified farm property" (a)(i)(D), (E), and "share of the capital stock of a family farm corporation"

These definitions are all relevant for the calculation of the capital gains exemption. An exemption in the amount of $500,000 is available during the lifetime of a taxpayer in respect of capital gains realized on the disposition of properties that are considered to constitute the family farm. The references to child in the definitions relate to conditions that must be met in order to qualify as property in respect of which the exemption applies. Generally these conditions relate to the use of the particular property.

C. Related to corporations and business partnerships

1. Spouse

Section 82(3)

Section 82 provides that taxable dividends may be included in the income of the spouse of the taxpayer in order to preserve the entitlement of the spouse of the taxpayer to the spousal tax credit. But for this rule, a spouse of an individual with no other income might lose entitlement to the spousal tax credit because that individual's income would be in excess of the amount permitted by section 118 by reason of receipt of the dividend income.

Section 96(1.1)(a)

Section 96(1.1) provides rules respecting the allocation of a share of income to a person who has ceased to be a member of a partnership. If the allocation is to a spouse of the partner, then the spouse is deemed to be a member of the partnership and therefore the partnership is not dissolved.

Section 204.81(1)(c)(v)(A), (c)(vii)

Section 294.81 provides the requirements to be met in order for a plan to be registered as a Labour Sponsored Venture Capital Corporation. Subsection (1)(a)(v) places limits on redemption by a corporation of Class A shares and provides an exception to that limitation for shares held by the individual, a spouse or former spouse of the individual where certain other conditions are met.

D. In respect of the family home

1. Spouse

Section 40(4)

Section 40(4) provides that where a taxpayer has transferred a principal residence to a spouse or a spouse trust and the transfer was either an inter vivos or post mortem rollover, then the spouse shall be deemed to own the residence for the period that it was owned by the taxpayer and the property shall be deemed to be the principal residence of the spouse for the period that it qualified as the principal residence of the taxpayer. In the case of a transfer to a spouse trust the trust shall be deemed to be resident in Canada during each year that the taxpayer was resident in Canada. The result is that the spouse or spouse trust steps into the shoes of the taxpayer for the purposes of the principal residence exemption.

Section 54.1(1)

Section 54.1 provides that a taxpayer who does not ordinarily inhabit their principal residence because either the taxpayer or their spouse has been transferred by their employer may elect that the house remains their principal residence until the taxpayer re-occupies the house or the taxpayer dies during the term of the taxpayer's or the spouse's employment by the employer who required the relocation.

2. Child

Section 54 definition of "principal residence" (c) and (c.1)(iv)

This definition provides, among other rules, that only one home may be designated as a principal residence for the purposes of the principal residence exemption by the members of the same family. For these purposes, the "family" does not include a married child under the age of 18.

E. Related to the death of the taxpayer

1. Spouse

Section 60(l) (ii)(A)(I) and (II), (v)(A) and (D)(I) and (v)(i)(A)

Section 60 (l) permits a deduction for amounts received by a spouse or dependant as a "refund of premiums" under an RRSP on the death of the annuitant or for a lump sum payment out of an RPP. Paragraph (v) permits a deduction for contributions made to a prescribed provincial pension plan by a taxpayer on their own account or to the account of their spouse.

Section 70(5.2)(b), (b)(ii), (d), and (d)(ii), (6)(a), (b)(i) and (ii), (d), (d.1)(ii) and (iii), (6.1) (a), (b)(i) and (ii), (7), (9), (9.1), (9.3)(b), (d), (e)(i) and (iii), (9.8)(a) and (b), (10) and (13)(b).

Section 70 contains numerous rules that apply on death of a taxpayer. Many of these rules permit various properties of the taxpayer to pass on a tax-free basis to the spouse or a spouse trust of the deceased taxpayer. In each case there is a deferral of tax until the spouse ultimately disposes of the property. Section 70(5.2)(b) permits certain resource properties to go on a tax-free basis (roll over) to a spouse or a spouse trust, though the legal representative of the deceased may elect a proceeds of disposition up to the fair market value of the property, thereby triggering some of the gain in the deceased's terminal year. The proceeds of disposition for the deceased is the cost of the property to the spouse or spouse trust. Land inventory of a deceased rolls over to a spouse or spouse trust. Section 70(6) provides a series of rules that permit a rollover of all capital property to a spouse or spouse trust provided certain conditions are met. Section 70(6.1) provides for the rollover of a net income stabilization account from a deceased taxpayer to a spouse or spouse trust. Section 70(7) provides a complicated method of untainting a testamentary spouse trust that is tainted by reason of a requirement to pay testamentary debts so that capital property can roll into the trust. This provision is often used by tax lawyers to realize part of a gain on the deemed disposition of capital property. This action permits any net capital losses of the deceased to be used up and the spouse or spouse trust receives a corresponding step up in the cost of the capital property. The effect is to split income between the deceased taxpayer and the spouse or spouse trust. Section 70(9) permits the transfer of certain farm properties to a child of the taxpayer at a value between cost and fair market value (thereby permitting a rollover) provided that the property was used principally in the business of farming by the deceased taxpayer, the taxpayer's spouse or any of the taxpayer's children on a regular and continuous basis prior to the taxpayer's death. Section 70(9.1) permits the transfer of certain farming properties from a spouse trust to the children of the settlor of the trust at a proceeds of disposition of an amount between cost and fair market value, thereby permitting a rollout of the property from the spouse trust. The idea is to ensure that if the taxpayer leaves farm property in trust for their spouse, that property can be transferred on death of the spouse on a tax-free basis to the children of the deceased taxpayer.

Section 70(9.3) permits the transfer of a family farm corporation or partnership from a spouse trust to the children of the settlor of the trust on a tax-free basis. Section (9.8) provides that leased farm property is deemed to be used in the business of farming in certain circumstances. Subsection (10) includes definitions related to the above noted provisions and subsection (13) is a consequential rule.

Section 72(2)

Section 72(2) applies where a deceased taxpayer was eligible to take a reserve under the Act and where the property in respect of which a reserve is taken is transferred to the taxpayer's spouse or a spouse trust. The provision permits the legal representative of the deceased taxpayer and the spouse to jointly elect that the spouse will step into the shoes of the deceased with respect to any future reserves.

Section 104(27.1)(e)

Section 104(27.1) provides that amounts paid to a testamentary trust from a deferred profit sharing plan as a consequence of the death of the settlor are eligible for the rollover to an RRSP under section 60(j), provided the amount can be considered to be part of the amount included in the income of the spouse of the settlor under section 104(13).

Section 146(1) definitions of "annuitant," "qualified investment," and "refund of premiums" and proposed amendment "refund of premiums", "retirement income," "retirement savings plan," and "spousal plan", subsections (3)(b)(i), (5.1)(a)(iii) and (iv), (8.1), (8.2)(a), (b) and (c), (8.21), (8.6), (8.7), (8.8), (8.91), (16)(b) and (c), (21)(a)(i), (ii) and (iii), and (b)(i)

Section 146 provides for the tax deduction for contributions to a RRSP and the sheltering of income in that plan. Many of the rules apply to spouses. In particular, an individual may contribute to an RRSP for their spouse (a spousal RRSP), within their own contribution limits. On death of a contributor to an unmatured RRSP, the funds in the plan can be transferred to a spouse as a refund of premiums and if the spouse contributes an equal amount to their RRSP, the funds pass on a tax-free basis. RRSP funds can be transferred on a tax-free basis to a spouse on marriage breakdown.

Section 146.01(1) definitions of "regular eligible amount", "replacement property" and "supplemental eligible amount" and (7)(b), (c)(i), and (d)

Section 146.01 permits the tax-free withdrawal of RRSP funds provided those funds are used to purchase a qualifying home. Certain restrictions apply and the funds must be repaid to the RRSP within a 15 year period. In order to qualify for the plan, neither the individual nor their spouse may have purchased the home more than 30 days before the funds are withdrawn and the spouse may not own a home in which the individual has resided since they became spouses. In the event of the death of the individual, the spouse may elect to assume the responsibilities of the individual to repay the amounts withdrawn by the deceased.

Section 146.3(1) Definitions of "annuitant", "minimum amount", "qualified investment" and "retirement income fund", (2)(d), (f)(iv), (5.1), (5.4), (6.11) and (14)(b)

Registered Retirement Income Funds may provide spousal benefits similar to those provided by Registered Retirement Savings Plans and on death may be transferred to a spouse's RRIF on a tax-free basis.

Section 147(19)(b)(ii)

Tax-free transfers may be made from a deceased spouse's Deferred Profit Sharing Plan to a surviving spouse's Registered Retirement Savings Plan, Registered Pension Plan or Deferred Profit Sharing Plan.

Section 147.3(7)(b)

Section 147(7) provides that on death of an individual, an amount may be transferred from their Registered Pension Plan to the Registered Pension Plan, Registered Retirement Savings Plan or Registered Retirement Income Plan of their spouse on a tax-free basis. The regulations also provide for spousal survivor benefits under a Registered Pension Plan.

Section 148(8.1) and (8.2)

Section 148 (8.1) and (8.2) provide that an interest in a life insurance policy may be transferred by the holder to a spouse either *inter vivos* or on death on a tax-free basis.

Section 248(1) definition of "death benefit"

The definition of "death benefit" means that a surviving spouse may receive up to $10,000 of the death benefit tax-free.

Section 248(8)(a) and (b)

Section 248(8) provides rules that expand the concept of "a transfer as a consequence of death" for the purposes of several rollover provisions that apply on death. Paragraphs (a) and (b) ensure that the rules apply to a transfer by a taxpayer or the taxpayer's spouse.

Section 248(9.2)(a)

In order for capital property to qualify for a rollover to a spouse or a spouse trust on death of the taxpayer, the property must vest indefeasibly in the spouse or the spouse trust. Section 248(9) provides that the property will not vest indefeasibly in a testamentary spouse trust unless the property vested indefeasibly in the trust before the death of the spouse and, in the case of an transfer to a spouse directly that the property vested indefeasibly in the spouse before the spouse's death.

Section 248(23.1)

Section 248(23.1)(a) provides that property transferred after the death of a taxpayer to a spouse under provincial laws relating to a taxpayer's interest in property is deemed transferred as a consequence of the death of the taxpayer, thereby ensuring that the property is eligible for the rollover to the spouse under section 70(6).

F. In respect of an *inter vivos* transfer of property

1. Spouse

Section 73(1), (2), (3), and (5)

Section 73 provides for the *inter vivos* transfer on a tax-free basis of different properties to a spouse. Subsection (1) permits the transfer of capital property to a spouse or former spouse on a rollover basis subject to certain conditions. Subsection (2) is an ancillary provision dealing with the transfer of depreciable capital property. Subsection (3) provides for the *inter vivos* transfer of farm property used principally in the business of farming by the taxpayer, the taxpayer's spouse or a child of the taxpayer to a child of the taxpayer. Subsection (5) provides for the rollover of a net income stabilization account from a taxpayer to a spouse or former spouse of the taxpayer.

Section 148(8.1) and (8.2)

Section 148(8.1) and (8.2) provide that an interest in a life insurance policy may be transferred by the holder to a spouse either *inter vivos* or on death on a tax-free basis.

G. Related to health and education

1. Spouse

Section 118.2(1)D(a), D(b) proposed amendment, (2) (a), (b), (b.1)(iii), (c)(ii), (l.b), (q), (2)(l.9), (l.10) proposed addition

Section 118.2 provides the medical expense tax credit. Any unused portion of a taxpayer's medical expense tax credit may be transferred to their spouse which means that either spouse may claim the credit for medical expenses incurred by the spouses. In addition proposed amendments provide that eligible medical expenses will include expenses for training courses relating to the care of a mentally or physically infirm person who is related to the taxpayer and is either a member of the taxpayer's household or is dependent on the individual for support.

Section 146.02(1) definition of "eligible amount", (2)(c)(ii), and (7)

Section 146.02 provides the Lifelong Learning Plan which provides for a tax-free withdrawal from a RRSP by the individual or the individuals spouse in order to pay for the individual's education.

Section 146.1(1) definition of "education savings plan", (7.2)(c)

Section 146.1 provides for the establishment of Registered Education Savings Plans in which money contributed will accumulate on a tax-free basis. Funds contributed to the RESP may subsequently be used to pay for post secondary education. The promoter of the RESP may enter into a contract with either the individual or the individual and their spouse. Provision is made for the tax-free transfer of any contribution to a spouse on breakdown of the marriage provided certain requirements are met.

H. Related to retirement and pensions

1. Spouse

Section 60(j)(i) and (j.2)(ii)(c), (l) (ii)(A)(I) and (II), (v)(A) and (D)(I) and (v)(i)(A)

Section 60 (j) to (l) permit the tax free rollover of retirement allowances and withdrawals from registered pension plans, deferred profit sharing plans, registered retirement savings plans and registered retirement income funds when paid into certain other plans. Paragraph 60(j) permits certain lump sum amounts to be transferred to a registered pension plan or registered retirement pension plan and paragraph 60(j.2) permits certain payments made on a periodic basis from a registered pension plan or deferred profit sharing plan to be transferred tax-free to a spousal registered retirement savings plan, up to a maximum of $6,000 each year.

Section 60.01(b)

Certain contributions made by a taxpayer or their spouse or a former spouse to a "foreign retirement arrangement" may be transferred on a tax-free basis to an RPP or an RRSP for the taxpayer's benefit.

Section 104(27)(c)(ii) and (d)(i)

Section 104(27) permits a testamentary trust to flow pension benefits through to a beneficiary so that the income qualifies for the pension credit and is eligible to be rolled into a registered retirement savings plan. The reference to spouse ensures that where the amount is an annuity out of the pension plan paid to a spouse of the settlor, the amount qualifies for the flow through.

Section 104(27.1)(e)

Section 104(27.1) provides that amounts paid to a testamentary trust from a deferred profit sharing plan as a consequence of the death of the settlor are eligible for the rollover to a registered retirement savings plan under section 60(j), provided the amount can be considered to be part of the amount included in the income of the spouse of the settlor under section 104(13) which requires that the amount be an amount payable to the beneficiary.

Section 118(7)(b)

Section 118(7) defines qualified pension income for the purposes of the pension credit as including certain amounts received by the individual on the death of the individual's spouse. This rule means that a deceased spouse's pension received by a surviving spouse qualifies for the pension tax credit.

Section 146(1) definitions of "annuitant," "qualified investment," and "refund of premiums" and proposed amendment "refund of premiums", "retirement income," "retirement savings plan," and "spousal plan", subsections (3)(b)(i), (5.1)(a)(iii) and (iv), (8.1), (8.2)(a), (b) and (c), (8.21), (8.3), (8.6), (8.7), (8.8), (8.91), (16)(b) and (c), (21)(a)(i), (ii) and (iii), and (b)(i)

Section 146 provides for the tax deduction for contributions to a RRSP and the sheltering of income in that plan. Many of the rules apply to spouses. In particular, an individual may contribute to an RRSP for their spouse (a spousal RRSP), within their own contribution limits. On death of a contributor to an unmatured RRSP, the funds in the plan can be transferred to a spouse as a refund of premiums and if the spouse contributes an equal amount to their RRSP, the funds pass on a tax-free basis. RRSP funds can be transferred on a tax-free basis to a spouse on marriage breakdown. Subsection (8.3) contains an anti-avoidance attribution rule intended to stop spouses income splitting by having an individual contribute to an RRSP from which the spouse withdraws the amount. The withdrawal will be taxed to the individual and not the spouse.

Section 146.3(1) Definitions of "annuitant", "minimum amount", "qualified investment" and "retirement income fund", (2)(d), (f)(iv), (5.1), (5.4), (6.11) and (14)(b)

Registered Retirement Income Funds may provide spousal benefits similar to those provided by RRSPs (see section 146 above).

Section 147(19) (b)(ii)

Tax-free transfers may be made from a deceased spouse's DPSP to a surviving spouse's RRSP, RPP or DPSP.

Section 147.3(5)(b) and (7)(b)

Subsection (5) provides that an amount may be transferred on marriage breakdown from the RPP of an individual to the RPP, RRSP or RRIF of their spouse on a tax-free basis. Subsection (7) provides that on death of an individual, an amount may be transferred from their RPP to the RPP, RRSP or RRIF of their spouse on a tax-free basis. The regulations also provide for spousal survivor benefits under an RPP.

Section 210(c)(ii)

Section 210 imposes a tax of 36% on trusts that have one or more non-resident beneficiaries or persons exempt from tax under section 149(1). The reference to spouse provides an exception where the person exempt from tax was a trust governed by a RRSP or a RRIF and acquired the interest from an individual or the spouse or former spouse of the individual who was immediately after the interest was acquired a beneficiary under the trust governed by the RRSP or RRIF.

2. Child

Section 104(27)

Section 104(27) permits a testamentary trust to flow pension benefits through to a beneficiary so that the income qualifies for the pension credit and is eligible to be rolled into an RRSP. The reference to child ensures that where the benefit is an amount paid to a child of the settlor, the amount qualifies for the flow through.

I. Related to divorce or separation

1. Spouse

Section 60(b)B

Section 60(b) provides for the deduction of spousal support payments.

Section 60.1(2)(a)

Section 60.1 is reciprocal to section 56.1 and provides a deduction for support payments made to a third party.

Section 146(8.8)

Section 146(8.8) provides that RRSP funds may be transferred on a tax-free basis to a spouse on marriage breakdown.

Section 146.1(1) definition of "education savings plan", (7.2)©

Section 146.1 provides for the establishment of RESPs in which money contributed will accumulate on a tax-free basis. Funds contributed to the RESP may subsequently be used to pay for post secondary education. The promoter of the RESP may enter into a contract with either the individual or the individual and their spouse. Provision is made for the tax-free transfer of any contribution to a spouse on breakdown of the marriage provided certain requirements are met.

Section 146.3

Section 146.3 provides that funds in a RRIF may be transferred on a tax-free basis to a spouse on marriage breakdown.

Section 147.3

Section 147.3 provides that funds in a Registered Pension Plan may be transferred on a tax-free basis to a spouse on marriage breakdown.

2. Child

Section 60(b)B

Section 60(b) provides for the deduction of child support payments made pursuant to an order made before May 1, 1997 and not varied after that time.

J. Miscellaneous provisions

1. Spouse

Section 58(5)

Section 58 provides the rules to be applied in determining the amount to be included in income in respect of certain government annuities issued before 1940. Subsection (5) provides that where section 58 permits the deduction of certain amounts in the computation of the portion of the annuity to be included in income, and both the taxpayer and their spouse receive annuity amounts, the taxpayer and their spouse may apportion the deduction in any manner they choose between themselves.

VII. PROVISIONS THAT ARE BASED ON AN ASSUMPTION OF ECONOMIC MUTUALITY AND THAT ARE DISADVANTAGEOUS FOR THE TAXPAYER

A. Corporations and business activity

1. Spouse

Section 24(2) (b), (c), and (d)(ii)

Certain rules apply when an individual ceases to carry on business. Section 24(2) provides that where the individual's spouse takes over the business, the cumulative eligible capital balance (in respect of the goodwill of the business) rolls over to a spouse. The consequence is that there is no deduction for the goodwill of the business, although there would have been such a deduction if the business had been disposed of to any other person.

Section 39(1)(c)(vi)(B) & (C) and (c)(vii)

Section 39(1) defines capital gain, capital loss and business investment loss. The reference to spouse provides that in the case of a share issued before 1972 or a substituted share, a business investment loss is reduced by any taxable dividend received by the taxpayer, the taxpayer's spouse or a trust of which the taxpayer or the taxpayer's spouse is a beneficiary.

Section 84.1 (2.2) (rules for paragraph 84.1(2)(b))

For the purposes of determining if a corporation is controlled by an individual, shares owned by the spouse of the individual are taken into account and effectively treated as if they were shares owned by the individual.

Section 130(3)(a)(vii)D

Section 130 provides for a low rate of tax on the income of investment corporations. In order to qualify as an investment corporation, certain requirements must be met, including the requirement that no shareholder (including a related person) can own more than 25% of the issued shares of the corporation at any time in the year. Subsection (3)(a)(vii)D provides that for the purpose of this ownership test an individual, the individual's child and the spouse of the individual are related persons.

Section 130.1(6)(d)(iv)

Income of a mortgage investment corporation can flow though the corporation and be taxed in the hands of the shareholder as interest income. In order to qualify as an investment corporation, no shareholder (including a related person) can own more than25% of the issued shares of the corporation at any time in the year. Subsection (6)(d)(iv) provides that for the purpose of this ownership test an individual, the individual's child and the spouse of the individual are related persons.

Section 212.1(3)(b)(i)

Section 212.1 is an anti-avoidance rule that prevents the removal of taxable corporate surplus as a tax-free return of capital through a non-arm's length transfer by a non-resident of shares from one Canadian corporation to another. Subsection (3) effectively treats the shares of one spouse as the shares of the other spouse.

Section 251.1(1)(a) and (b)(iii)

Section 251 defines affiliated persons for the purposes of the Act. The definition includes an individual and their spouse and a corporation and a spouse of a person by whom the corporation is controlled, as well as a corporation and a spouse of a person who is a member of an affiliated group of persons by whom the corporation is controlled. The definition primarily applies with respect to the rules that apply to the acquisition of capital property and denies losses on the disposition of the property in certain circumstances.

2. Child

Section 84.1 (2.2) (rules for paragraph 84.1(2)(b))

For the purposes of determining if a corporation is controlled by an individual, shares owned by the child of the individual are taken into account.

B. Family home

1. Spouse

Section 40(2)(b)D(i), (b)D(i)(A), (b)D(i)(B)

Section 40(2) establishes the principal residence exemption which allows the disposition of the family home on a tax free basis for the period that it qualifies as a principal residence. These rules apply to a principal residence acquired prior to February 23, 1994 and in respect of which an election under 110.6(19) was made to crystallize an exempt capital gain. The rules provide an amendment to the calculation of the amount that is eligible for tax-free treatment that takes into account any capital gains exemption claimed by the taxpayer or their spouse. The result is an integration of the principal residence rules and the special election under section 110.6(19) in respect of the capital gains exemption.

Section 54 definition of "principal residence" (a), (a.1), (c), (c.1)(ii)(B), and (c.1)(iv)

Section 54 includes several rules that relate to spouse and the principal residence exemption. First, a home qualifies as a principal residence if it is inhabited for the period in question by the taxpayer, the taxpayer's spouse or former spouse or a child of the taxpayer. Secondly, if the taxpayer is a personal trust then the home must be inhabited by the specified beneficiary of the trust, the spouse or former spouse of the beneficiary or by the child of the beneficiary. Thirdly, only one home may be designated in a given year as a principal residence by members of one family which is considered to be the taxpayer, the taxpayer's spouse and any unmarried children of the taxpayer under 18. Similar rules apply where the taxpayer is a personal trust.

Section 146.01(1) definitions of "regular eligible amount", "replacement property" and "supplemental eligible amount" and (7)(b), (c)(i), and (d)

Section 146.01 permits the tax-free withdrawal of RRSP funds provided those funds are used to purchase a qualifying home. Certain restrictions apply and the funds must be repaid to the RRSP within a 15 year period. In order to qualify for the plan, neither the individual nor their spouse may have purchased the home more than 30 days before the funds are withdrawn and the spouse may not own a home in which the individual has resided since they became spouses. In the event of the death of the individual, the spouse may elect to assume the responsibilities of the individual to repay the amounts withdrawn by the deceased.

2. Child

Section 54 definition of "principal residence" (a), (a.1), (c), (c.1)(ii)(B), and (c.1)(iv)

Section 54 includes several rules that relate to spouse and the principal residence exemption. First, a home qualifies as a principal residence if it is inhabited for the period in question by the taxpayer, the taxpayer's spouse or former spouse or a child of the taxpayer. Secondly, if the taxpayer is a personal trust then the home must be inhabited by the specified beneficiary of the trust, the spouse or former spouse of the beneficiary or by the child of the beneficiary. Thirdly, only one home may be designated in a given year as a principal residence by members of one family which is considered to be the taxpayer, the taxpayer's spouse and any unmarried children of the taxpayer under 18.

C. Disposition of capital property

1. Spouse

Section 54 definition of "superficial loss"

This section provides that if one spouse acquires property of another spouse within 30 days of disposition of the property by the other spouse, the spouse who originally disposed of the property may not take a capital loss.

D. Related to divorce or separation

1. Spouse

Section 56(1)(b)

Section 56(1)(b) requires the inclusion in income of child support (in certain circumstances) and spousal support.

Section 56.1(2)(a) and (4)

Section 56.1(2) extends the basic support provision in section 56(1)(b) to include certain support payments made to the third parties which are required to be included in the income of the person in respect of whom the payments are made. Subsection (4) defines "support amount" and "child support amount".

Section 118(5)

Section 118(5) precludes a single parent from claiming the equivalent to spouse tax credit for a child in respect of whom the parent is required to make child support payments.

E. Related to retirement and pensions

1. Spouse

Section 40(2)(g)(iv)(B)

This section provides that losses from a spousal RRSP are deemed to be nil.

F. Miscellaneous

1. Spouse

Section 64(a)A(i)

Section 64 provides a deduction for attendant care expenses which may be taken by individuals eligible for the disability tax credit. No deduction may be taken for attendant care expenses provided by a spouse.

Section 81(1) (h)

Section 81(1) provides that social assistance payments received by a taxpayer for the benefit of another person are, in certain circumstances, not included in the income of the taxpayer. Paragraph (h) provides that this rule does not apply in respect of payments made for the benefit of the taxpayer's spouse or a person who is related to the taxpayer or the taxpayer's spouse.

Section 122.61 (1) E

This section provides a mechanism for the Minister to recover an overpayment of the Canada Child Tax Benefit and the calculation of the amount of the overpayment takes into account, among other factors, 25% of the child care expenses deduction taken by either the taxpayer or the taxpayer's spouse.

Section 163(2)(c)(i)

Section 163(2) prescribes the penalty for false statements and omissions in respect of tax returns and other forms. In the case of the Child Tax Benefit, the calculation of the penalty takes into account the fact that the spousal income is relevant to the calculation of entitlement to the Canada Child Tax Benefit.

VIII. JOINT LIABILITY

Section 160(1)(a) and (4)

Section 160(1) provides that both spouses are jointly and severally liable for tax arising in respect of property transferred between them.

Section 160.1(2.1)

Section 160.1(2.1) provides that both spouses are jointly and severally liable for any repayment of an overpayment of the Canada Child Tax Benefit.

IX. PROVISIONS THAT RELATE TO SPOUSAL TRUSTS

A. Spouse

Section 104(4) (a)(iii), (iv), (a.1) and (5.1)

Section 104 (4) to (5.2) provides for the deemed disposition at fair market value every 21 years by a trust, of certain of its properties. Paragraph (a)(iii) provides that if the trust is a spousal trust, the deemed disposition occurs on the date of the death of the spouse. Where the trust is a pre-72 spousal trust the deemed disposition occurs on the day that is the later of the day on which the spouse dies and January 1, 1993.

Section 104(15)(a)

Section 104(15) provides for the preferred beneficiary election and establishes limits for pre-72 spousal trusts on the amount that is eligible for the election.

Section 108(1)(d) and (e) definition of "accumulating income"

Section 108(1) defines accumulating income for spousal trusts.

Section 108(1) definition of "pre-1972 spousal trust"

Section 108(1) defines a pre-72 spousal trust.

Section 108(1) definition of "preferred beneficiary"

A preferred beneficiary includes the spouse or former spouse of the settlor of the trust and the child, grandchild or great grandchild or the spouse of any such person.

Section 108(4)

A pre-72 spousal trust is not tainted by reason of the payment of estate taxes, succession duties or any income tax payable by the trust in respect of the income of the trust. The result is that the trust will qualify for the preferential treatment given to pre-72 spousal trusts.

Section 110.6(12)(a)(i) and (ii), (c)(i) and (ii)

Section 110.6(12) provides for use of the capital gains exemption by a spousal trust.

IX. CONSEQUENTIAL PROVISIONS

A. Spouse

Section 40(3.18) (a)(ii), (a)(iv), (c)(iii)

Section 40(3.1) provides for a deemed gain at the end of the fiscal period of the partnership in respect of the disposition of the partnership interest for a member of a partnership who is a limited partner if the adjusted cost base of the partnership is negative at the end of that fiscal period. There are certain exclusions to the deemed gain rule in subsection (3.1). Subsection (3.18) provides that a partner who acquired a partnership interest after February 22, 1994 will be deemed to have held the interest on February 22, 1994 for the purposes of the exclusion within (3.1) if the partnership interest rolled to the partner from a spouse or spouse trust and was an "excluded" interest immediately before the death of the partner or partner's spouse.

Section 45(4)

Section 45(3) provides that where there would be a deemed disposition of income producing property by reason of a change in use of that property to a non-income producing purpose and the property use is changed to that of a principal residence, the taxpayer may elect not to have the deemed disposition occur. Section 45(4) provides that the 45(3) election may not be made where capital cost allowance has been claimed in respect of the property by the taxpayer, the taxpayer's spouse or a trust under which the taxpayer's spouse is a beneficiary.

Section 110.6(20) (a)(i) and (29)

Section 110.6 (19) and (20) provides for the crystallization of capital gains effective February 22, 1999 (the date of repeal of the capital gains exemption for capital property other than the family farm and shares of a small business corporation). The references to spouse in paragraph (a)(i) and (29) are consequential provisions.

Section 204.2(1)(b)(i) and (ii)

Section 204.2 defines the excess amount for a year prior to 1991 in respect of an RRSP and the reference to spouse is intended to include the spousal RRSP in the ambit of the definition.

Section 204.2(1.2), (2) and (3)

Section 204.2 provides for the calculation of the amount of undeducted RRSP premiums and the references to spouse bring spousal RRSPs within the ambit of the section.

Section 212(1)(h)(iii.2)

Section 212 imposes a tax of 25% on certain Canadian source income of non-residents. Subsection (1)(h) imposes the tax on pension benefits other than certain benefits that would, if the non-resident had been resident in Canada, be deductible in computing the income of the individual or the individual's spouse.

Section 118(7)(b)

Section 118(7) defines qualified pension income for the purposes of the pension credit as including certain amounts received by the individual on the death of the individual's spouse. This rule means that a deceased spouse's pension received by a surviving spouse qualifies for the pension tax credit.

B. Married Person

Section 118(4)(a.1), proposed amendment

Section 118(4) provides limiting rules with respect to the equivalent to married (spouse) tax credit and the proposed amendment provides that if a marital (spousal) tax credit is claimed for a tax year in respect of a person by an individual and the individual and that person are married to each other and are not separated, neither the individual nor any other individual may claim the equivalent to spouse tax credit in respect of that person for the year.

C. Child

Section 56(1)(b)B

Paragraph 56(1)(b) requires the inclusion of child support payments in income with respect to child support orders made pursuant to an order made before May 1, 1997 and not varied after that time.

Section 56.1(2)(b), (3)(b), (4) definitions of "child support amount," (b)(ii) and (iii), "commencement day", and (b) "support amount"

Section 56.1 (2) and (3) provide some of the detailed rules that apply to the inclusion in income of child support payments in certain circumstances. Subsection (4) defines terms related to those rules.

Section 64.1 (a), and (c)

Section 64.1 includes special rules that apply when the taxpayer claiming the child care expenses deduction is resident in Canada but absent therefrom for a period of time.

Section 104(5.4)(b)(ii)

Section 104 (5.3) provided for the deferral of the 21 year deemed disposition for some trusts. Subsection (5.4) defined an exempt beneficiary for those purposes, but is now irrelevant as subsection (5.3) is being repealed.

APPENDIX B

LEGISLATIVE HISTORY OF PRIMARY PROVISIONS OF THE *INCOME TAX ACT* THAT REFER TO MARRIED PERSONS AND SPOUSAL RELATIONSHIPS

The following material relates to the legislative history discussed in Chapter Two. It includes material on the attribution rules, the spousal tax credit, the definition of "spouse", the inclusion/deduction system for spousal support (alimony) and the rollover of capital property to a spouse or child.

***Income War Tax Act 1917*, 7-8 Geo. V, c. 28**

s.4 (1) There shall be assessed, levied and paid, upon the income during the preceding year ... the following taxes:

(a) 4 per centum upon all income exceeding fifteen hundred dollars in the case of unmarried persons and widows or widowers without dependent children, and exceeding three thousand dollars in the case of all other persons

* this provision was repealed and replaced with a similar provision using identical terminology by S.C. 1918, c.25, s.3

* the 1918, c.25 provision was repealed by S.C. 1919, c.55, s.3 and replaced with the following:

> 4(1) There shall be assessed, levied and paid upon the income ... the following taxes:

(a) four per centum

upon all income exceeding one thousand dollars but not exceeding six thousand dollars in the case of unmarried persons and widows or widowers without dependent children, and persons who are not supporting dependent brothers or sisters under the age of eighteen years, or a dependent parent or parents, grandparent or grandparents, and exceeding two thousand dollars but not exceeding six thousand dollars in the case of all other persons...

* the 1919, c.55 provision above was repealed by S.C. 1922, c.25 and replaced with the following:

4(1)(a) four per centum upon all income exceeding two thousand dollars but not exceeding six thousand dollars in the case of a married person, or any other person who has dependent upon him any of the following persons:

(i) a parent or grandparent;
(ii) a daughter or sister;
(iii) a son or brother under twenty-one years of age or incapable of self-support on account of mental or physical infirmity;

and four per centum upon all income exceeding one thousand dollars but not exceeding six thousand dollars in the case of all other persons...

* s.4 (4) is a general attribution rule that provides that if a transfer of property is made to a "wife or husband" [terms not defined] and the purpose is to evade tax, the transferor is liable to be taxed as if transfer had not been made.

***An Act to amend the Income War Tax Act 1917*, S.C. 1926, c.10.**

s.1 of this Act, adds and defines the following terms to s.2 [definition section] of the *Income War Tax Act*, 1917:

(n) "householder" means
(i) an individual who at his own and sole expense maintains a self-contained domestic establishment employing therein on full time a housekeeper or servant, or
(ii) an individual who maintains a self-contained domestic establishment and who actually supports and maintains therein one or more individuals connected with him by blood relationship, marriage or adoption;

(o) "self contained domestic establishment" means a dwelling house, apartment or other similar place of residence, containing at least two bedrooms, in which residence amongst other things the taxpayer as a general sleeps and has his meals prepared and served.

* these definitions appear as 2(f) and 2(j) respectively in the IWTA R.S.C. 1927, c.28

s.4 of this Act amends the "rates of tax" found in s.4(1) of the IWTA 1917, as amended, and adds the following subsection to s.4 of the IWTA, 1917:

> 1(A) Taxpayers shall be entitled to the following exemptions:
>
> (a) Three thousand dollars in the case of a married person or householder or any other person who has dependent upon him any of the following persons:
> (i) A parent or grandparent,
> (ii) A daughter or sister,
> (iii) A son or brother under twenty-one years of age or incapable of self-support on account of mental or physical infirmity;
> (b) Fifteen hundred dollars in the case of other persons, and
> (c) Five hundred dollars for each child under twenty-one years of age who is dependent upon the taxpayer for support...

*the amount of this exemption was reduced by S.C. 1932, c.43, s.4

> 1(B) Where a husband and wife have each a separate income in excess of fifteen hundred dollars, each shall receive an exemption of fifteen hundred dollars in lieu of the exemption set forth in paragraph (c) of the immediately preceding subsection...
>
> 1(C) The exemption for each dependent child may be taken by either parent under arrangement between themselves. In the event of any dispute arising between them, then the said exemption or exemptions shall be allotted to the father of the said child or children.

* the immediately above provisions appear as s.5(1)(c), 5(2) and 5(3) respectively in the Revised Statutes, 1927, c.28

***The Income War Tax Act, 1917*, R.S.C. 1927, c.28**

The structure of the IWTA is as follows in the Revised Statutes, 1927:

s.2 - definitions
s.3 - taxable income defined
s.4 - excepted incomes
s.5 - deductions and exemptions allowed
s.6 - deductions from income not allowed
s.7 and 8 - deductions from taxes allowed

s.9 - persons taxable:

> There shall be assessed, levied and paid upon the income during the preceding year of every person
>
> [paragraphs (a) - (e) resident in Canada etc]
>
> a tax at the rates applicable [...] set forth in the First Schedule of this Act upon the amount of income in excess of the exemptions provided in this Act [...]

First Schedule - "Rates of Tax Applicable to Persons other than Corporations and Joint Stock Companies"

An Act to amend the Income War Tax Act 1917, S.C. 1932-33, c.41

s.2 of this Act repeals the definition of "householder" - see above

s.4 of this Act repeals paragraphs (c), (d) and (e) of s.5 of the RSC, 1927 and substitutes the following :

> [5(1) "Income" as hereinbefore defined shall for the purposes of this Act be subject to the following exemptions and deductions:]
>
> (c) Two thousand dollars in the case of
> (i) A married person;
> (ii) A widow or widower with a son or daughter under twenty-one years of age who is dependent upon such parent for support, or if twenty-one years of age or over is likewise dependent on account of mental or physical infirmity;
> (iii) An individual who maintains a self-contained domestic establishment and who actually supports therein one or more individuals connected with him by blood relationship, marriage or adoption [...]
> (d) One thousand dollars in the case of all other persons [...]
> (e) Four hundred dollars for each child or grandchild [...]

* This provision was repealed by S.C. 1940, c.34 and replaced with a similar provision, which included the following addition:

> 5(1)(c)(iv) A minister or clergyman in charge of a diocese, congregation or parish, whose duties required him to maintain at his own and sole expense a self-contained domestic establishment and who employs therein on full time a housekeeper or servant...

* This provision was further amended by S.C. 1940-41, c.18, s.11 which added the following subsection:

5(5) A taxpayer shall not be allowed the exemptions provided in paragraphs (c), (e) and (i) [dependent relatives] of s.5(1) unless the spouse, child, grandchild parent, grandparent, brother or sister [...] is resident in Canada [...]

***An Act to amend the Income War Tax Act 1917*, S.C. 1942-43, c.28**

s.1 of this Act repeals paragraph A ["Rates of Tax Applicable to Persons other than Corporations and Joint Stock Companies"] of the First Schedule of the IWTA R.S.C., 1927 and replaces them with the following:

A. Rules for Computation of Income Tax under subsection 1 of section 9:

Section 1. Normal Tax

Rule 1. A normal tax equal to 7 per centum of the income shall be paid by every person whose income during the year exceeded $1,200 and who was during that year:

(a) a married person [...]
(b) a widow or widower with a son or daughter wholly dependent upon such person for support, if such son or daughter was [...]
  (i) under eighteen years of age; or
  (ii) eighteen years of age or older and dependent by reason of mental or physical infirmity; or
  (iii) under twenty-one years of age and a student [...]
(c) an unmarried person who maintained a self-contained domestic establishment and actually supported therein a person wholly dependent upon him and connected with him by blood relationship, marriage or adoption; or
(d) an unmarried minister or clergyman [...] who maintained a self-contained domestic establishment and employed therein on full-time a housekeeper or servant.

* note that the margin note next to this rule reads: "Married persons and persons given equivalent status"

Rule 2. If, during any taxation year, a husband and his wife each had a separate income in excess of $660, each shall be taxed under Rule three of this section, provided, however, that a husband shall not lose his right to be taxed under Rule one of this section by reason of his wife being employed and receiving any earned income.

Rule 3. Every person not liable to taxation under Rule one or Rule two of this section shall pay a normal tax equal to [...]

Rule 5. [tax credit for dependents]

(a) child, grandchild, brother or sister [...]
(b) parent or grandparent [...]

Section 2. Graduated Tax

Rule 1. [provides for $660 deduction from income for every person]

Rule 2. [rates, which are linked to the amount of income of the taxpayer]

Rule 3. [tax credit of $150 for married persons and those persons receiving equivalent status - same as Rule 1 in section 1 above]

Rule 4. [tax credit for dependents - child or grandchild]

Rule 5. [tax credit for dependents - parent or grandparent]

Rule 6. If, during any taxation year, a husband and his wife each had a separate income in excess of $660 before making the deduction for which provision is made in Rule one of this section, neither of them shall be entitled to the deduction from graduated tax for which provision is made in Rule three of this section, provided, however, that notwithstanding the foregoing a husband shall not lose his right to the deduction provided in Rule three of this section by reason of his wife being employed and receiving any earned income but his wife shall for the purposes of this section be treated as an unmarried person.

Rule 7. The deduction in respect of any dependent child, for which provision is made in Rule four of this section may [...] be made from the tax payable by such of his parents as may be determined by agreement between them, but if there is no such agreement, such deduction shall be made from the father's tax unless the Minister otherwise determines.

Section 3. General [...]

This Act contains three provisions re: alimony:

s.3(2) provides that alimony received shall be included in income; s.7(1) provides that alimony paid cannot be deducted from income; and s.11 adds the following to the IWTA, R.S.C. 1927:

s.11 The said Act is ... amended by inserting the following section [after s.8 of the IWTA, 1927]:

8A. Any person who is required [...] to make and does make any payment as alimony or other allowance for the maintenance of the recipient thereof and the children of the marriage if any, may, if he is living apart from the

> spouse or former spouse to whom he is required to make such payments, deduct from the taxes otherwise payable by him [...] the amount of the tax which such spouse or former spouse would pay upon [...] such payments [...] if such payments were the only income of such spouse or former spouse and such spouse or former spouse were an unmarried person resident in Canada with no dependents except the children, if any, for whose maintenance such payments were, in part, made.

* s.7(1) and s.11 of this Act [6(1)(g) and 8A respectively of the IWTA] are repealed by S.C. 1944-45, s.43 - see below

***An Act to amend the Income War Tax Act 1917*, S.C. 1944-45, c.43**

s. 1(2) of this Act adds the following subsections to s.2 [definition section] of the IWTA:

2(2) "child of a taxpayer" defined
2(3) definitions [...]
  (a) "parent"
  (b) "grandparent"
  (c) "brother"
  (d) "sister"
  (e) "son"
  (f) "daughter"

s.4 of this Act amends section 5 [deductions and exemptions allowed] of the IWTA, R.S.C. 1927, c.97, including the addition of the following paragraph:

> (8)(t) an amount paid by the taxpayer [...] as alimony [...] if he is living apart from the spouse or former spouse to whom he is required to make the payment.

* note that this provision no longer requires that the alimony payment must be the only income received by the recipient - [see above]

s.5 of this Act repeals s.7 of SC 1942-43, c.28 [re alimony - see above]

s.7 of this Act repeals s.8A enacted by s.11 of SC 1942-43, c.28 [re: alimony - see above]

s.21 of this Act repeals subparagraphs (a), (b) and (c) of Rule 1 of section 1 of paragraph A ["Rules for Computation of Income Tax under subsection 1 of section 9"] of the First Schedule and substitutes:

(a) a married person who supported his spouse [...]
(b) [substitutes "a person" for "a widow or widower"]

(c) an unmarried person or a married person separated from his spouse who maintained a self-contained domestic establishment and actually supported therein a person wholly dependent upon him and connected with him by blood relationship, marriage or adoption.

*s.25 makes similar amendments to Rule 3 of section 2 of paragraph A of the First Schedule.

s.22 of this Act repeals Rule 2 of section 1 of paragraph A of the First Schedule [see above] and replaces it with the following:

> Rule 2. If ... a married person described by subparagraph (a) of Rule 1 [ie. as amended by this Act] of this section and his spouse each had a separate income in excess of $660, each shall be taxed under Rule 3 of this section: Provided that a husband does not lose his right to be taxed under Rule 1 of this section by reason of his wife being employed and receiving any earned income.

*s.28 similarly amends Rule 6 of s.2 of paragraph A of the First Schedule.

s.24 adds Rule 7 to section 1 of para A of the First Schedule:

> Rule 7: Where a taxpayer is entitled to make a deduction from his income for the taxation year under par. (t) of 5(1) IWTA [...] [alimony] [...] the spouse or child shall, for the purposes of this section, be deemed not to be the spouse or child of the taxpayer.

*s.28(2) adds a similar provision for the purposes of s.2 of paragraph A of the First Schedule as Rule 9.

***An Act to amend the Income War Tax Act 1917*, S.C. 1945, c.23.**

s.9 of this Act adds Section 4 to paragraph A of the First Schedule:

> Section 4. Tax payable by persons benefiting from both family allowances under *The Family Allowances Act*, 1944 and allowances under this Act for children.
>
> Rule 3 of this section [4] provides:
>
> > "For the purpose of this section a taxpayer shall be deemed to be a married person if he is entitled to a deduction from tax under Rule 3 of s.2 of this paragraph A" (see above).

***An Act to amend the Income War Tax Act 1917*, S.C. 1946, c.55.**

s.1(1) of this Act amends 2(1) [definitions] of the IWTA, R.S.C. 1927, c.97 by adding:
(x) words importing the masculine include the neuter [sic].

***The Income Tax Act*, S.C. 1947-48, c.52**

** Replaces the *Income War Tax Act*

s.6(d) - Alimony received must be included in recipient's income

s.11(j) - Alimony paid may be deducted from payor's income

Division C - Computation of Taxable Income

s.25 (1) For the purpose of computing the taxable income of an individual for a taxation year, there may be deducted from his income for the year such of the following amounts as are applicable:

(a) $1500 in the case of a taxpayer who [...] was

(i) a married person who supported his spouse,
(ii) a person who had a child wholly dependent upon him for support, if the child was [...],
(iii) an unmarried person or a married person not supporting his spouse who maintained a self contained domestic establishment and actually supported therein a person wholly dependent upon him and connected with him by blood relationship, marriage or adoption, or
(iv) an unmarried minister or clergyman [...] who maintained a self-contained domestic establishment and employed therein a full-time servant;

(b) $750 in the case of an individual not entitled to a deduction under par. (a);

(c) for each child or grandchild [...],

(d) other dependents [...].

(2) [Limitations on s.1 deductions for spouse - ie. where spouse has income] [...]

(5) Where a taxpayer is entitled to a deduction [...] under para.(j) of 11(1) in respect of a payment for the maintenance of a spouse or child, the spouse or child, for the purposes of this section, be deemed not to be the spouse or child of the taxpayer.

Part VI - Interpretation

s.127(1) In this Act,

(ak) "self-contained domestic establishment" means a dwelling-house, apartment or other similar place of residence in which place a person as a general rule sleeps and eats.

* note that the original definition said "has his meals prepared and served"

* this definition remains in s.248(1) of the 1970-71-72 Act, as amended to the present.

* no significant changes to the ITA, S.C. 1948, c.52 [ITA, R.S.C. 1952, c.148] until its repeal by S.C. 1970-71-72, c.63

***An Act to Amend the Income Tax Act*, 1970-71-72, c.63**

s. 1 of this Act:

ITA, R.S.C. 1952, as amended, repealed (except s.1 and Parts IV and VIII)
ITA, R.S.C. 1970 declared not in force by 1970-71-72, c. 43, s.1;

Section 70 [rollover on death of taxpayer of capital property to a spouse]

70(6) Where any property of a taxpayer to which paragraphs (5)(a) and (c) or paragraphs 5(b) and (d), as the case may be, would otherwise apply has, on or after the death of the taxpayer and as a consequence thereof, been transferred or distributed to

(a) his spouse, or

(b) a trust created by the taxpayer's will under which

  (i) his spouse is entitled to receive all of the income of the trust that arises before the spouse's death, and

  (ii) no person except the spouse may, before the spouse's death, receive or otherwise obtain the use of any of the income or capital of the trust,

and both the taxpayer and the spouse or trust, as the case may be, were resident in Canada immediately before the death of the taxpayer, the following rules apply:

(c) paragraphs (5)(a) to (d) are not applicable to the property;

(d) the taxpayer shall be deemed to have disposed of the property immediately before his death and to have received proceeds of disposition therefor equal to,

  (i) where the property was depreciable property of the taxpayer of a prescribed class, that proportion of the undepreciated capital cost to him of the property immediately before his death that the fair market value at that time of all of the depreciable property of the taxpayer of that class, and

(ii) in any other case, the adjusted cost base to the taxpayer of the property immediately before his death,

and the spouse or trust, as the case may be, shall be deemed to have acquired the property at the same amount; and

(e) where the property was depreciable property of the taxpayer of a prescribed class, paragraph (5)(e) is applicable as if the reference therein to "paragraph (b)" and to "paragraph (d)" were read as references to "paragraph (6)(d)".

* subsection 70(6) is repealed and replaced by S.C. 1973-74, c.14, s.19(2)

Section 73(1) [inter vivos rollover of capital property to a spouse]

73(1) For the purposes of this Part, where at any time after 1971 any particular capital property has been transferred by a taxpayer to his spouse, or to a trust created by him under which

(a) his spouse is entitled to receive all of the income of the trust that arises before the spouse's death, and

(b) no person except that spouse may, before the spouse's death, receive or otherwise obtain the use of any of the income or capital of the trust,

and both the taxpayer and the spouse or trust, as the case may be, were resident in Canada at that time, the particular property shall be deemed to have been disposed of at that time by the taxpayer for proceeds equal to,

(c) where the particular property is depreciable property of a prescribed class, that proportion of the undepreciated capital cost to the taxpayer immediately before that time of all property of that class that fair market value immediately before that time of the particular property is of the fair market value immediately before that time of all of that property of that class, and

(d) in any other case, the adjusted cost base to the taxpayer of the particular property immediately before that time,

and to have been acquired at that time by the spouse or trust, as the case may be, for an amount equal to those proceeds.

* subsections 73(1) and (2) are repealed and replaced by S.C. 1977-78, c.32, s.15.

Principal Residence

54(g) "principal residence" of a taxpayer for a taxation year means a housing unit, or a share of the capital stock of a co-operative housing corporation, owned, whether jointly with another person or otherwise, in the year by the taxpayer, if the housing unit was, or if the share was acquired for the sole purpose of acquiring the right to inhabit a housing unity owned by the corporation that was,

(i) ordinarily inhabited by the taxpayer in the year, or
(ii) property in respect of which the taxpayer has made an election for the year in accordance with subsection 45(2),

except that in no case shall any such housing unit or share, as the case may be, be considered to be a taxpayer's principal residence for a year

(iii) unless it has been designated by him in prescribed manner to be his principal residence for that year and no other property has been so designated by him for that year, or
(iv) by virtue of subparagraph (ii), if by virtue of that subparagraph the property would, but for this subparagraph, have been his principal residence for 4 or more of the previous taxation years,

and for the purposes of this paragraph the "principal residence" of a taxpayer for a taxation year shall be deemed to include, except where the property consists of a share of the capital stock of a co-operative housing corporation, the land subjacent to the housing unit and such portion of any immediately contiguous land as may reasonably be regarded as contributing to the taxpayer's use and enjoyment of the housing unit as a residence [...]

* S.C. 1973-74, c.14, s.14(1) repeals and replaces all that portion of paragraph 54(g) preceding subparagraph (iii)

1974-75-76, c.26

s.26(1) *The Income Tax Act* is further amended by adding thereto, immediately after section 54 thereof, the following subsection:

54.1(1) A taxation year in which a taxpayer does not ordinarily inhabit his property as a consequence of the relocation of his place of employment while he is employed by an employer who is not a person to whom he is related shall be deemed not to be a previous taxation year referred to in subparagraph 54(g)(iv) if

(a) the property subsequently becomes ordinarily inhabited by him during the term of his employment by that employer or before the end of the taxation year immediately following the taxation year in which his employment by that employer terminates, or
(b) he dies during the term of his employment by that employer.

1976-76, c.4 *** ss.14 and 15 add spouse to 54(g) and 54.1 respectively ***

14(1) Subparagraph 54(g)(i) of the *Income Tax Act* is repealed and the following substituted therefor:

> (i) ordinarily inhabited in the year by the taxpayer, his spouse or former spouse, or a child of the taxpayer who, during the year, was wholly dependent upon him for support and was a person described in subparagraph 109(1)(d)(i), (ii) or (iii), or

***An Act to amend the Income Tax Act*, S.C. 1980-81-82-83, c.140**

s.130(1) of this Act - applicable after 1981 - adds:

> s.252(3) For the purposes of [list several paragraphs [...], "spouse" and "former spouse" include a party to a voidable marriage.

***An Act to amend the Income Tax Act*, S.C. 1988, c.55**

s.92(1) of this Act adds s.118(1) [conversion of exemptions to tax credits]:

(a) Married status -- in the case of an individual who at any time in the year is a married person who supports the individual's spouse, an amount [...]

(b) Wholly dependent person ["equivalent to spouse" credit] -- in the case of an individual who does not claim a deduction for the year because of par. 118(1)(a) and who, at any time in the year,

  (i) is an unmarried person or a married person who neither supported nor lived with the married person's spouse and is not supported by the spouse; and
  (ii) whether alone or jointly with one or more other persons, maintains a self-contained domestic establishment (in which the individual lives) and actually supports in that establishment a person who, at that time, is

    (A) except in the case of a child of the individual, resident in Canada
    (B) wholly dependent for support on the individual, or the individual and the other person or persons, as the case may be,
    (C) related to the individual, and
    (D) except in the case of a parent or grandparent of the individual, either under 18 years of age or so dependent by reason of mental or physical infirmity, an amount [...]

***An Act to amend the Income Tax Act*, S.C. 1990, c.35**

s.13(6) of this Act adds:

> 146(1.1) For the purposes of the definitions "annuitant," "refund of premiums" and "retirement income" in subsection (1), para.(3)(b) and subsections (8.8), (8.91) and (16),
>
> "spouse" of an individual means a person of the opposite sex
>
> (a) who is married to the individual; or
> (b) who is cohabiting with the individual in a conjugal relationships and
>   (i) has so cohabited for a period of at least one year, or
>   (ii) is a parent of a child of whom the individual is a parent.

s.16(1) of this Act adds s.147.1(1):

> "spouse" of an individual has the meaning assigned by subsection 146(1.1)

***An Act to amend the Income Tax Act*, S.C. 1994, c.7, Schedule VIII**

s.82(5) of this Act repeals s. 146(1.1) [definition of spouse - see above]

s.85(2) of this Act repeals s.147.1(1) [see above]

s.140(2) of this Act amends s.252(3) [see above] - applicable to the 1991 and subsequent taxation years - to read:
"for the purposes of [paragraphs ...], "spouse" and "former spouse" of a particular individual include another individual of the opposite sex who is a party to a voidable or void marriage with the particular individual.

s.140(3) of this Act enacts s.252(4):

> In this Act,
>
> (a) words referring to a spouse at any time of a taxpayer include the person of the opposite sex who cohabits at that time with the taxpayer in a conjugal relationship and
>   (i) has so cohabited with the taxpayer throughout a 12-month period ending before that time, or
>   (ii) would be a parent of a child of whom the taxpayer would be a parent, if this Act were read [...] (as amended in 1994 and 1998)
>
> and, for the purposes of this paragraph, where at any time the taxpayer and the person cohabit in a conjugal relationship, they shall, at any particular time after that time, be deemed to be cohabiting in a conjugal relationship unless they were

not cohabiting at the particular time for a period of at least 90 days that includes the particular time because of a breakdown of their conjugal relationship;

(b) references to marriage shall be read as if a conjugal relationship between 2 individuals who are, because of para 252(4)(a), spouses of each other were a marriage;

(c) provisions that apply to a person who is married apply to a person who is, because of para 252(4)(a), a spouse of a taxpayer; and

(d) provisions that apply to a person who is unmarried do not apply to a person who is, because of para 252(4)(a), a spouse of a taxpayer.

An Act to amend the Income Tax Act, S.C. 1997, c.25

s.25(2) of this Act amends s.118(1)(a) as follows:

> Married status -- in the case of an individual who at any time in the year is a married person who supports the individual's spouse and is not living separate and apart from the spouse by reason of a breakdown of their marriage, an amount [...]

Bill C-23, *The Modernization of Benefits and Obligations Act*

Section 139(2) of this Act amends section 248 of the Act by adding the following:

"common-law partner", with respect to a taxpayer at any time, means a person who cohabits at that time in a conjugal relationship with the taxpayer and

(a) has so cohabited with the taxpayer for a continuous period of at least one year and

(b) would be the parent of a child of whom the taxpayer is a parent if this Act were read without reference to paragraphs 252(1)(c) and (e) and subparagraph 252(a)(iii),

and for the purposes of this definition, where at any time the taxpayer and the person cohabit in a conjugal relationship, they are, at any particular time after that time, deemed to be cohabiting in a conjugal relationship unless they were not cohabiting at the particular time for a period of at least 90 days that includes the particular time because of a breakdown of their conjugal relationship;

"common-law partnership" means the relationship between two persons who are common-law partners of each other.

Section 142 amends the Act by replacing "spouse" and "spouses" with "spouse or common-law partner" and "spouses and common-law partners" in every provision in which the former terms are to be found.

APPENDIX C

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